UNIT 8 CAPITAL MARKET I : NEW ISSUES MARKET

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8.0 OBJECTIVES

After going through this unit you will be able to :

- explain the concept of capital market and its segments,
- describe the various means to raise the capital in the primary market,
- describe the reforms in primary capital market, and
- state the recent trends in new issues market in India.

8.1 INTRODUCTION

We know that Financial markets are broadly categorized into Money market and Capital market. In the previous Unit, we have studied the functioning of money market and its various instruments. In this Unit, we will deal with the capital market.

The process of industrial growth requires the development of the capital market, which provides long-term finance to entrepreneurs. The capital market is a wide term and includes all transactions involving long-term funds. The development banks, commercial banks, financial institutions and stock exchanges, are its important components. The Securities and Exchange Board of India (SEBI) is the regulator over the Capital Market. Capital market is an organized market for effective and efficient mobilization of funds from the

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numerous savers and transfers the funds to those who are in need of money to finance business operations either in the private sector or in the public sector. In other words, capital market brings together the parties who demand the funds (Industry and Business) and who supply the funds (Investors). Capital Market, therefore, is a link between savings surplus sector (Household) and saving deficit sector (Industry).

In the Capital Market, we largely deals with the securities such as equity shares, preference shares, bonds and debentures issued by corporates, semi-Government organizations and Governments.

8.2 PRIMARY MARKET AND SECONDARY MARKET

The Securities Market is divided into two segments—the Primary Market and the Secondary Market. The main difference between these two lies in the fact that while the former deals with the securities, which the issuer issues for the first time, the latter deals in the existing securities. Thus, the primary market facilitates the transfer of investible funds of the savers to the corporates, which need them for productive purposes. In the Secondary Market, no new securities come into existence, rather the existing securities change hands—one set of persons invest in them, while the other group disinvests. The Primary Market, also called the New Issues Market, is of vital importance in the economy of a country, as it leads to better utilisation of otherwise inactive or dormant monetary resources in the economy.

These two markets are not isolated from each other, rather they are very much inter-dependent. Activities in the new issues market and the response of the investors to the new issues of securities depend upon the prevailing conditions in the Secondary Market. If the secondary market is vibrant and booming, issues of new securities in the Primary Market will be easily able to mobilise support of a large number of investors and vice-versa. We shall study in this Unit the existing practices for floating new issues in the Securities Market.

8.3 METHODS OF FLOATATION OF NEW ISSUES

There are three ways in which a company may raise capital in the primary market.

i) Public Issue

ii) Rights Issue

iii) Private Placement

8.3.1 Public Issue

The most important mode of issuing securities is by issuing prospectus to the public. If the issue has been made for the first time, by a corporate body, it is known as Initial Public Offer (IPO).

The procedure followed in cases of public issue is as follows:

Invitation to subscribe the share is made through a document called 'prospectus'. The applications on the prescribed form, along with application money, are invited by the company. The subscription list is open for a period of 3 to 7 days.

No allotment can be made unless, the amount stated in the prospectus as the minimum subscription has been subscribed, and the company has received sum payable on application. Minimum subscription refers to the number of shares, which should be subscribed. As per the SEBI guidelines, minimum subscription has been fixed at 90% of entire public issue.

Generally, the amount is mobilized in two instalments- application money and allotment money. If the full amount is not asked for at the time of allotment itself, the balance is called up in one or two calls thereafter known as call money. The letter of allotment sent by the company is exchangeable for share certificates. If the allottee fails to pay the calls, his shares are liable to be forfeited. In that case, allottee is not eligible for any refund.

The public issue may also be underwritten by an underwriter. Underwriting is not mandatory now. An underwriter gives an undertaking, to the issuing company to take the unsubscribed shares. This is called devolvement of shares on the underwriters, for which they are paid a commission.

In India underwriting agencies can be classified into following categories: 'sole underwriting', 'syndicate underwriting', a 'sub-underwriting under sole underwriting'. An underwriter enters into an agreement for underwriting with the issuing company all alone. Syndicate underwriting is used when the investment bankers form a syndicate to purchase the securities of company because money needed for such venture may be larger than any one banker may like to invest. The third underwriting method i.e. sub-underwriting, involves appointment of a sub underwriter to quicken the sale of securities and diversify the risk involved. Two types of agreements are involved in underwriting, e.g.

- Agreement between issuing company and the underwriters
- Agreement between the underwriter(s) and sub-underwriter(s)

8.3.2 Rights Issue

A rights issue involves selling securities in the primary market by issuing rights to the existing shareholders. In this method the company gives the privilege to its existing shareholders for the subscription of the new shares on pro rate basis. A company making a rights issue sends a letter of offer along with a composite application form consisting of four parts A, B, C, and D. Part A is meant for acceptance of the offer. Part B is used if the shareholder wants to renounce his rights in favour of someone else. Part C is filled by the person in whose favour the renunciation has been made. Part D is used to request the split of the shares. The composite application form must be mailed to the company within a stipulated period, which is usually 30 days. The shares that remain unsubscribed will be offered to the public for subscription. Sometimes an existing company can come out with a simultaneous 'Right cum Public Issue'.

The important characteristics of rights issue are:

1) The number of shares offered on rights basis to each existing shareholder is determined by the issuing company. The entitlement of the existing shareholder is determined on the basis of existing shareholding. For example one Rights share may be offered for every 2 or 3 shares held by the shareholder.

2) The issue price per Rights share is left to the discretion of the company.

3) Rights are negotiable. The holder of rights can transfer these rights shares to any other person, i.e. he can renounce his right to subscribe to these shares in favour of any other person, who can apply to the company for the allotment of these shares in his name.

4) Rights can be exercised during a fixed period, which is usually 30 days. If it is not exercised within this period, it automatically lapses.

8.3.3 Private Placement

A Public Issue is a costly affair involving Press advertisements, brokers, fees and Press conference, etc. Therefore, some of the companies find it easy and cheaper to raise funds through private placement of bonds and shares.

In this method, the securities are issued to some selected investors like banks or financial institutions. The private placement agreement is undertaken when the issue size is not very big and the issuer does not want to spend much on floating the issue. Private placement market has grown phenomenally. During the last few years in India, the rate of growth of private placements has been higher than public issues as well as right issues because of following advantages:

i) **Accessibility:** Whether it is a public limited company, or a private limited company, or whether it is listed company or an unlisted one, it can easily access the private placement market. It can accommodate issues of smaller size, whereas public issue does not permit issue below a certain minimum size.

ii) **Flexibility:** There is a greater flexibility in working out the terms of issue. A private placement results in the sale of securities by a company to one or few investors. In case of private placement, there is no need for a formal prospectus as well as under-writing arrangements. Generally, the terms of the issue are negotiated between the company (issuing securities) and the investors.

When a non-convertible debenture issue is privately placed, a discount may be given to institutional investor to make the issue attractive.

iii) **Speed:** The time required, for completing a public issue is generally 6 months or more because of several formalities that have to be gone through. On the other hand, a private placement requires lesser time.

iv) **Lower Issue Cost:** A public issue entails several statutory and non-statutory expenses associated with underwriting, brokerages etc. The sum of these costs used to work out even upto 10 percent of issue. For a company going for a private placement it is substantially less.

Check Your Progress 1

1) What are the different ways in which a company can raise its capital?

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2) What is private placement? What are its advantages?

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3) Which document does provide the details of the proposed public issue?

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4) What is underwriting of an issue?

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8.4 ENTRY NORMS FOR NEW ISSUES

The experience of free pricing of new issues, introduced in 1992, did not prove useful, as there was great influx of companies in the new issues market, at high premium. The Securities and Exchange Board of India imposed strict norms for the entry of companies in the new issues market in April 1996. It requires that only those companies will be allowed entry into the share market, which have track record of dividend payments in the last 3 years. This requirement was changed in 1999 to ability to pay dividend in each of the 3 years. Alternatively, in case of manufacturing companies, its project must have been appraised by a scheduled bank/ financial institution, which is also providing loan/equity to the extent of 10% of the project cost. Thus, only profit earning and dividend-paying existing companies and new companies, with their projects appraised by banks/ financial institutions, are permitted to enter into the new issues market. This step has been taken to improve the quality of shares being issued in the primary market. You will study the full details of the SEBI guidelines in Unit-10.

8.5 FIXATION OF PREMIUM

Companies are allowed to issue their securities at par, at a premium or at a discount. When the issue price is equal to the face value of the security, it is issued at par, if the former exceeds the latter, it is issued at a premium, and in the reverse condition at a discount. The amount charged from the investors above the face value is called **'Premium'**. For example, if the share of the face value of Rs. 10, is issued for Rs. 15, the extra amount of Rs. 5/- is called Premium.

Till May 1992, companies were required to seek the permission of the Controller of Capital Issues, under the

Control on Capital Issues Act, to issue capital above the permitted amount. The amount of premium was also determined by the Controller of Capital Issues, taking into account various facts relating to the Company's functioning.

In May 1992, the above Act was repealed and instead the Securities and Exchange Board of India (SEBI) was empowered to exercise control over the new issues market as well. The SEBI subsequently permitted the companies to determine the premium themselves. However, SEBI issued guidelines in this regard, which divided the companies into three categories, and within each category, companies which fulfilled conditions of consistent profit for specific number of years are permitted to charge premium. Rest of them is permitted to issue the shares at par only. This led to great rush in the new issues market and companies charged heavy premium for their issues. You will study the details of these guidelines in Unit-10 dealing with Regulatory framework for Capital Market.

8.5.1 Book Building Process

A new system to determine the amount of premium to be charged by a company on its new issues was introduced in October 1995, when SEBI permitted the system known as **'Book Building'**. It is a pricing mechanism wherein new issues are priced on the basis of demand feedback. Under this system, the price of the new issue is based on real time feedback from the investors.

The mechanism adopted under the Book Building is as follows:

- A draft prospectus containing all information, except the price and the number of securities, is filed by the Company with SEBI.
- A lead merchant banker to the issue is appointed as Book Runner.
- The Book Runner will circulate copies of the prospectus amongst the institutional investors and underwriters inviting offers for subscription to the security.
- The Book Runner maintains a record of the offers received from the institutional investors and underwriters mentioning the price they are ready to pay and the number of securities they intend to buy.
- On the basis of these offers, the Company and the book runner will determine the price of the security. The price, so determined, will be the same for both placement position and the public issue.

- Thereafter, the Underwriting Agreement is entered into and prospectus is filed with the Registrar of Companies.
- One-day prior to the public issue, institutional investors are required to submit application forms along with money to the extent the securities are proposed to be allotted to them.

Initially, the book-building process was optional to the companies, but gradually, an element of compulsion has been introduced.

During the fiscal year 2000-01, the book-building route was made compulsory for companies, which do not have the track record of profitability and networth as specified in Entry norms prescribed by SEBI.

Moreover, 60% of the offer made by them is to be allotted to 'Qualified Institutional Buyers', comprising financial institutions, banks, mutual funds, Foreign Institutional Investors (FIIs) and Venture Capital Funds registered with SEBI. Inability to meet this condition is regarded as failure of the issue.

The book-building route has also been made compulsory for IPOs with issue size more than 5 times the pre-issue networth and for public issues by listed companies worth more than 5 times the pre-issue net worth. In these cases also, 60% of the offer should be allotted to QIBs.

Check Your Progress 2

1) What do you mean by the premium? Who can charge premium?

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2) What do you understand by entry norms for new issues? Discuss briefly.

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3) What is book-building process?

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8.6 REFORMS IN PRIMARY CAPITAL MARKET

SEBI has brought about several reforms in the new issues market during recent years. Important reforms are as detailed below:

i) **Minimum offer to public:** SEBI (Disclosure and Investor Protection) Guidelines required a minimum offering of 25% of post-issue capital to the public. This requirement was gradually relaxed to 10% for companies in all sectors. For this purpose, SEBI also kept the minimum offering size at Rs.100 crore and retained the existing limit of minimum public offering of 20 lakh shares. The Companies which are unable to meet these conditions are required to make a minimum public offering of 25%.

ii) **Lock-in-period**: The provisions for lock-in applicable to IPOs have been rationalized. Lock-in-period for minimum promoters' contribution of 20 per cent continues to be 3 years, the balance of the entire pre IPO Capital held by promoters and others shall have lock-in period of 1 year from the date of allotment of the IPO.

   The shares issued on preferential basis by a listed company to any person shall have a lock-in period of one year term from the date of their allotment.

iii) **Allotment of Shares:** The time for finalizing the allotment of share has been reduced from 30 days to 15 days, in case, issues are made on book-building basis.

iv) Merchant bankers have been brought under SEBI regulatory framework and a code of conduct is issued for them.

v) Companies are required to disclose all material facts and specific risks factors associated with their projects while making public issues through the prospectus.

vi) Prohibition has been imposed on payment of any direct or indirect discounts or commission to person receiving any firm allotment of shares.

vii) The requirement of 90% minimum subscription in case of offer for sale is no longer applicable.

viii) Underwriting of the issue made optional subject to the condition that if an issue was not underwritten and was not able to collect at least 90% of amount offered to public as subscription, the entire amount will be refundable to investors.

ix) SEBI introduced a code of advertisement for public issues for ensuring fair and truthful disclosures

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8.7 RECENT TRENDS IN NEW ISSUES MARKET IN INDIA

The new issues market in India has passed through both the phases of boom and depression during the last decade. The number of new public issues shoot up from 528 in 1992-93 (Amount Rs. 6060.83 crores) to 770 in 1993-94 (Rs. 12544 crores) and thereafter to 1343 and 1428 during 1994-95 and 1995-96 amounting to Rs. 13311.00 and Rs. 10981.72 crores respectively. This was largely due to optimistic outlook following free pricing of shares allowed by SEBI.

Table-8.1 shows the mobilization of resources from the primary market during the last few years. The following trend emerges from the table:

i) Though, the numbers of issues and their amounts have increased during recent past from 367 (Rs. 59044 crores) in 1997-98 to 737 (Rs. 73921 crores) in 2000-01, the major portion was raised through private placement route. Within this category, public sector dominated and accounted for a bigger portion. IDBI, IFCI, ICICI, IIBI were the largest mobilizers of funds in this category, followed by state level undertakings. Thus, we may conclude that private placement of shares/debentures, bonds, etc. have become popular because of adverse sentiments towards equities and lower cost of placement route. The willingness of banks and other financial institutions to subscribe to debt instruments through private placement has also been a contributing factor.

ii) The number of new issues through prospectus and rights, which fell to 51 in 1998-99, rose to 83 in 1999-2000 and further to 150 in 2000-01. But their amounts continuously declined from Rs. 9365 crores to Rs. 6421 crores. These figures include both of the public issues through prospectus and the rights issues.

iii) Public Sector undertakings and Government companies remained absent from the public issues market during the last three years. Resource mobilization by banks and financial institutions in the public sector declined sharply.

iv) Out of 145 issues made by Non-Government public limited companies, 134 issues were of equity shares, the remaining being debt issues. But in terms of resource mobilization, the shares of equity instruments was only 53.9%. Most of the issues during 2000-01 were of Rs. 10 crores and less, while in the previous year most of the issues were of Rs.10 crore and above. As a result, the average size of issues by private sector companies sharply declined to Rs. 34 crores from Rs. 65 crores in 1999-2000 and Rs. 104 crore in 1998-99.

v) The above figures of total amount mobilized by equity issues include the amount of premium also. The share of premium in the total amount mobilized by equity shares declined sharply to 47.5% in 2000-01 from 78.8% in the 1999-2000, while it was 51.7% in 1998-99. This rise in premium was due to successful initial public offering of companies in Information Technology Sector.

In brief, it can be stated that the public issues market in India at present is not very attractive to the retail investors because of the economic slow down and the depressed share prices in the Secondary Market. Corporates have, therefore, preferred the route of private placement of debt instruments. Resource mobilization through IPOs accounted for only 5.5% of the total resource mobilization during April-December 2001, compared with 56.7% in the corresponding period of last year. Banks and financial institutions raised about 70% of this amount. Amount raised by IT Companies was less than 1%. In March 2002, Punjab National Bank, however, made its successful IPO, which was over-subscribed by over 4.5 times and that too at a premium of Rs. 21 per share of Rs. 10 each. It shows revival of the small investors interest in the IPOs, especially those of banks and financial institutions.

Table 8.1
Mobilisation of Resources from the Primary Market in India

(Amount in crore rupees)

Security & Type of Issue	1997-98		1998-99		1999-2000		2000-2001	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
A: Prospectus & Rights			**51**	**9,365.1**	**83**	**7,704.3**	**150**	**6,421.1**
(1) Non-Govt Public Ltd. Companies	102	3,138.3	48	5,013.1	79	5,153.3	145	4,948.9
(a) Equity Shares	89	1,162.4	33	2,562.7	69	2,752.5	134	2,666.5
(b) Preference Shares	1	4.3	3	59.7	—	—	2	142.2
(c) Debentures	12	1,971.6	12	2,390.7	10	2,400.8	9	2,140.2
(2) Banks and Financial Institutions			3	4,352.0	4	2,551.0	5	1,472.2
B: Private Placement			**316**	**49,679.0**	**578**	**61,259**	**587**	**67,500**
(1) Private Sector			180	16,997.7	367	19,403.5	387	24,398.8
(2) Public Sector			136	32,681.3	211	41,855.5	200	43,101.2
Total (A+B)			**367**	**59,044**	**661**	**68,963.3**	**737**	**73,921.3**

Source: Annual Report of Reserve Bank of India (2000-2001)

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Check Your Progress 3

Match the following:

	A	B
i)	Lock in Period for minimum promoters' distribution of 20% continues to be	(a) 90
ii)	SEBI's guidelines require a minimum offering of post issue of capital to the public to the percentage	(b) 3
iii)	The minimum percentage subscription in case of offer for sale is no longer	(c) 25

8.8 LET US SUM UP

Financial Market is broadly categorised into Money Market and Capital Market. Capital Market deals with the long-term funds such as equity shares, preference shares, bonds and debentures issued by the corporate sector, semi-government organizations and other financial institutions.

The security market is divided into two segments-Primary Market and Secondary Market. The former deals with the securities, which the issuer issues for the first time, while the latter deals in the existing securities. Any company can raise the capital in the primary market by three ways, namely—Public Issue, Rights Issue and Private Placement. Companies are allowed to issue their securities either at par, or at a premium, or at a discount.

The Securities and Exchange Board of India (SEBI) has imposed strict norms for entry of companies in the new issues market with effect from April, 1996. A new system namely **'Book Building'** has been adopted by SEBI to determine the amount of premium to be charged by a company. SEBI has brought several reforms in the new issues market during recent years. These include minimum offer to public, lock-in-period for minimum promoters' contribution of 20% and reduction of time from 30 days to 15 days for finalising the allotment of shares.

Recent trends in new issues market in India indicate revival of the small investors' interest in the primary issues specially those of banks and financial institutions.

8.9 KEY WORDS

Bonds : Bond refers to a security issued by a company, financial institution, or Government, which offers regular or fixed payment of interest in return.

Boom : A condition of the market denoting increased activity with rising prices and higher volume of the business resulting from greater demand to securities.

Buyback : The arrangement agreed to between the company and its investors to buy back the securities at a later date for a specific price.

Coupon Rate : It is the rate of interest, which the issuer pays in the principal/paid up value of the bond. It is fixed at the time of issuance of the bond.

Deep Discount Bonds : This bond is issued at a discount on the face value. The face value is paid at the maturity. These bonds are also known as Zero Coupon Bonds.

Gilts : Fixed interest securities by the government to raise money for public expenditure in India by auction across.

Securities & Exchange Board of India (SEBI) : Set up in April 1988 by the Government of India with the objective of promoting healthy and orderly development of the securities market and ensuring investors protection.

Split : Sub division of share of large denomination into share of smaller denomination. Also means sub division of holding.

Stag : An application for a new issue of shares that hopes to sell the shares on allotment at a profit once trading commences in the secondary market. A speculator is one who buys and sells stocks rapidly for fast profits.

Underwriting : An individual or institution guaranteeing subscription in part or in full of a security issue at a later date for a specified price.

Volatility : A measure of the price moment of a security during a specific period.

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8.10 SOME USEFUL BOOKS

Verma, J.C. (1997): *'Venture Capital Financing in India'*, Response Books, Sage Publication India (Pvt. Ltd).

Marilu Hurt Mc. Carty (1988): *Money & Banking Financial Institutions and Economic Policy* (2nd Edition), Longman Financial Services Publishing, USA, Chapter 4, PP. 80-86.

Economic Survey: 1999-2000, Chapter 4, P.P. 59-73

Report on Currency and Finance, 1991-92: Chapter 9, Capital Market, PP. 294-307, Reserve Bank of India, Mumbai

8.11 ANSWERS/HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) Company can raise capital through public issue, rights issue and private placement.

2) If securities are issued to some selected investors, it is referred to as private placement. Easy accessibility, flexibility and the lower cost are its main advantages.

3) Prospectus

4) Underwriting of issue refers to the promise committed by a third party that the underwriter will take up the subscribed shares.

Check Your Progress 2

1) Premium refers to the difference between issue price and the face value of the security. Companies under the norms of SEBI can charge premium.

2) See Section 8.4

3) See Sub-section 8.5.1

Check Your Progress 3

i) (b) ii) (c) iii) (a)

UNIT 9 CAPITAL MARKET II : SECONDARY MARKET

Structure

9.0 Objectives
9.1 Introduction
9.2 Stock Exchange in India
9.3 Trading System at Stock Exchange
   9.3.1 Traditional Trading System
   9.3.2 On-Line Trading System
9.4 Settlement Procedure for Traded Securities
9.5 Transfer System
9.6 Dematerialisation of Securities
9.7 National Stock Exchange
9.8 Over the Counter Exchange of India (OTCEI)
9.9 Trading in Derivatives
9.10 Let Us Sum Up
9.11 Key Words
9.12 Some Useful Books
9.13 Answers/Hints to Check Your Progress

9.0 OBJECTIVES

After reading this Unit, you will be able to :

- explain the system of Stock Exchanges in India,
- categorise trading, settlement and transfer system on Stock Exchanges,
- analyse dematerialisation of shares,
- describe working of National Stock Exchange and Over the Counter Exchange of India, and
- illustrate trading in derivatives as introduced in India.

9.1 INTRODUCTION

We have learned in Unit 8 that Capital Market largely deals with the securities such as equity shares, preference shares, bonds and debentures. We also know that securities market is divided into two segments, namely the primary market and secondary market.

The secondary market of securities is an important component of the capital market. It is the market where shares, bonds, debentures and other securities are traded. Once these securities are floated, subscribed to and issued to the public, they are traded in the secondary market, which is called **'Stock Market'**.

Stock Market provides liquidity and easy marketability to these securities. Thus, an active secondary market in turn encourages investors to subscribe to the securities in the primary market. The growth and development of the primary market is, therefore, largely dependent upon the vibrant secondary market.

9.2 STOCK EXCHANGES IN INDIA

The market where securities are traded is called the **'Stock Exchange'**. Presently there are 23 Stock Exchanges in the country. Bombay Stock Exchange (BSE) is the oldest and principal Stock Exchange in India. During the last decade, National Stock Exchange (NSE) with its wide network across the country, has become the premier stock exchange in the country. Another new nation-wide exchange is 'Over the Counter Exchange of India (ICEI)'.

The Stock Exchange in India are organised either as voluntary non-profit making organizations or as public limited companies—limited by shares or by guarantees. The Stock Exchange are to be registered with the Central Government and function within the purview of the Securities Contracts (Regulation) Act, 1956 (SCRA). This Act governs the Organization, management, membership and functioning of Stock Exchanges. Moreover, the Stock Exchange is governed by their own rules and bye-laws. The Securities and Exchange Board of India (SEBI) overviews and governs the functioning of Stock Exchanges and their participants. The recognised Stock Exchange is managed by a governing body consisting of elected and nominated members. The Executive Director is the Chief Executive of the exchange.

9.3 TRADING SYSTEM AT STOCK EXCHANGES

Dealing in securities at the Stock Exchange has traditionally been undertaken on the trading floor of the Stock Exchange. This traditional system is now been largely replaced by computerised on-line system of trading. We shall first deal with the traditional system of trading, followed by the new on-line system.

9.3.1 Traditional Trading System

Dealings at a stock exchange are permitted only in the listed securities. The term 'listing of securities' means that the security concerned has been included in the list of securities to be transacted at the Stock Exchange. Only listed securities are allowed to be traded on a stock exchange. Therefore, at the time of making a public issue, companies declare that the security concerned has either been listed

at one or more stock exchange or, an application has been made for that purpose. Listed securities fall in two categories :

i) **Cash List:** It involves ready delivery, and

ii) **Forward List:** It enjoys forward trading privilege.

A security can be listed by the Stock Exchange, if the issuer company fulfils the prescribed conditions.

Transactions at the Stock Exchanges are undertaken through the brokers. Brokers are also now-a-days regulated by Securities and Exchange Board of India. When a person intends to buy or sell shares/bonds of a company, he places an order for the same with a broker registered at the stock exchange. Broker's authorised clerk will carry out the customer's order at the trading floor of the stock exchange by undertaking a transaction with another broker or jobber. Jobber is a person who quotes two-way prices—the bid price and the offer price. After a transaction is finalised, it is noted in the notebooks. Contract notes are prepared and sent to the customer intimating the transaction undertaken for him.

9.3.2 On-line Trading System

A revolutionary change of great significance has taken place with the introduction of on-line trading system, which has replaced the traditional system. The Bombay Stock Exchange introduced this system, which is known as **Bombay Stock Exchange On-Line Trading (BOLT)**.

Under the On-Line Trading System, the trading floor dealings have been discarded. Brokers transact business through their computers, which are linked with the main computer of the Stock Exchange through VSATs (Very Small Aperture Terminals), which have started functioning at various centres. This facility has been extended to other cities also where a stock exchange is already present. A Memorandum of Understanding (MoU) between BSE and other exchanges is signed to allow BSE to install its terminals in their areas.

The *modus operandi* of On-Line Trading is very simple. As soon as a broker receives an order from his customer, he feeds the details of the order into the computer, e.g. the name of company, no. of shares to be purchased/sold, the ceiling price or the price at which the transaction is intended to be made and the time within which is to be completed. The screen of the computer will fully display the present details regarding the security concerned. If the present position does not facilitate the transaction, the computer will store the order and will match it with a corresponding reverse order, as soon as it is feasible. It means that as and when the desired shares are available for sale at the desired

price, the deal is struck and the computer screen will display the completion of the transaction. The broker will, thereafter, issue the contract note.

There are several advantages of the On-Line Trading System. It makes the securities market transparent, as the customer can himself see the market price on the screen. It makes the security market wide and deep. It serves a larger number of investors spread over different locations and covers a large number of securities. The difference in prices of securities at different locations/markets is reduced. It is very convenient, fast and efficient.

Other exchanges have also been permitted to set-up computerised screen based trading system. They can also expand nation-wide subject to certain conditions.

Check Your Progress 1

1) What do you understand by Stock Exchange? Who exercises control over them?

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2) Explain the traditional trading system at a Stock Exchange.

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3) What do you understand by 'On-Line Trading System? Point out its benefits.

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9.4 SETTLEMENT PROCEDURE FOR TRADED SECURITIES

For the purpose of settlement, securities are divided into two groups:

i) **Specified Securities** include actively traded shares of large growth-oriented companies. Only a limited number of shares fall in this group but they account for major portion of capitalisation in Indian Stock Market.

ii) **Non-Specified Securities** are securities other than the specified securities.

There are two methods for settlement of transactions in specified securities:

i) **Carry Forward System:** Under this system, the transactions are settled at the end of each settlement period, which is generally of two weeks commencing on Friday and ending on Thursday of second following week. At the end of the settlement period on Friday, the members decide whether the transaction is settled or if it is to be further carried forward. The carry forward of transactions is called *'badla'*.

In case of non-specified, securities *'badla'* transaction were not allowed. The clearing house handles only the money part and actual delivery of securities is handled by members themselves.

Badla System or Carry Forward System was abolished on December 13, 1993. In October, 1997 SEBI introduced modified carry forward system. Finally SEBI banned 'badla' on July 2, 2001.

ii) **Rolling Settlement System:** In January, 1998 SEBI introduced rolling settlement system on a voluntary basis on the Stock Exchanges for securities, which were eligible for demat trading. In January 2000, compulsory rolling settlement was introduced for 10 scrips. By May 2000, the number of such scrips was gradually increased to 163 and with effect from July 2, 2001 to 251. Rolling settlement was extended to the remaining scrips on all stock exchanges by December 31, 2001.

Thus, rolling settlement system has substituted the Badla System. Now all the scrips are traded in the rolling settlement mode. Initially, rolling settlement was on T + 5 basis, but from April 1, 2002, settlement cycle for all securities has been shortened to T + 3 basis. It means that payment and delivery of securities is to be completed within three days after the day of the transaction. Thus, the rolling settlement system is a significant improvement in the stock market. It will enhance the efficiency and integrity of the securities market.

The payments and deliveries are made by members through the clearing house of the Stock Exchange. They deposit cheques/drafts and securities certificates on the pay-in-day specified by the Stock Exchange. After examining the same, the cleaning house makes the payment and delivers the securities certificates to the members on the pay-out-day, i.e. next Wednesday

The brokers, who trade in securities at the Stock Exchange, have to meet margin requirements also. They have to deposit daily margins in cash for every contract of purchase and sale outstanding at the end of the day for scrips in the

specified group only. Generally, the rate of daily margin varies between 5% and 25%. It is calculated on cumulative aggregate purchase and sales by members, remaining outstanding at the end of each day. They have to deposit other margins also as imposed by the stock exchanges.

9.5 TRANSFER SYSTEM

After the transaction is complete by settlement and delivery of share certificates to the buyer, the latter has to get the share certificates transferred in his own name. For this purpose, the transferor has to sign on the prescribed Transfer Deed, which must be duly stamped, dated and witnessed. Thereafter, it is signed by the transferee and along with share certificate is sent to the registered office of the issuer company (or its registrars who handle the shareholders' register and transfers). The company will tally transferor's signature with his specimen signatures (given at the time of applying for the shares) and other details. If everything is found in order, the shares are transferred in the name of the transferee and an endorsement to this effect is made on the back of the share certificate. Necessary entries are also made in the Register of Members. Share certificates are then sent back to the transferee. Company is allowed two month's time to complete this transfer procedure.

The above is the traditional or conventional method of transfer of shares held in the physical form. With the setting up of Depositories, most of the shares are now not held in the physical form, but in dematerialised form. The system of transfer of shares in demat form is very simple, as explained below.

9.6 DEMATERIALISATION OF SECURITIES

One of the most important reforms in the Indian Capital Market has been the introduction of dematerialisation of securities. Dematerialisation means that the securities do not exist in the physical form, i.e. in the form of share/bond certificates, but holding of such securities are only recorded in the books of an institution called Depository. Whenever, a shareholder transfers his shares to another person, he informs the Depository which makes necessary entries in its books to record such transaction. Thus, the transfer process is facilitated and made foolproof without various disadvantages of physical transfer of shares.

The enactment of Depository Act, 1996 in July 1996 and notification of SEBI (Depository and Participants) Regulations, 1996, have provided a legal framework to record ownership details in a book entry form. The Depository Act, 1996 allows for dematerialisation and (rematerialisation) of

securities in depositories and transfer of securities through electronic book entry. This will help in reducing settlement risks and removing some of the infrastructural bottlenecks. The dematerialised securities are to be fungible, meaning that they will not have any distinctive number or specific identification.

The Depository Act vests SEBI with the power of registration of depositories and participants and to approve or amend the bye-laws of a depository. After the notification of the SEBI (Depository and Participants) Regulations, 1996, the National Securities Depository Limited (NSDL) has been set up. The NSDL, sponsored by IDBI, UTI and NSE commenced operation in October, 1996. NSDL employs state-of-the-art technology and professional management and has introduced international standards and practices of securities handling to the Indian capital market. The setting up of the first depository in the country is a milestone, which is expected to upgrade the trading and settlement system in line with that prevailing in the developed markets. With dematerialisation, all the problems of loss in transit and bad delivery disappear as also the seemingly arbitrary power of companies to refuse transfer on the flimsy grounds are going to be a thing of past.

About 80% of the scrips listed on the stock markets have been dematerialised by October, 2001. For dematerialisation, investors have to open an account with any of the participants and return the share certificates to the company which destroys them and book entries are made in electronic form by the depository.

9.7 NATIONAL STOCK EXCHANGE

National Stock Exchange (NSE) was incorporated in 1992 to provide nation-wide stock trading facilities. Its promoters are the leading financial institutions, e.g. IDBI, IFCI, ICICI, LIC, GIC, SEBI Capital Markets Ltd., Stock Holding Corporation of India and Infrastructure Leasing and Financial Services Ltd. It provides a fully automated screen-based trading system.

NSE has two segments:

i) **Wholesale Debt Market Segment:** In this segment, institutions including subsidiaries of banks engaged in financial services and corporate bodies can enter into high value transactions in debt instruments such as Public Sector Undertaking bonds, treasury bills, Government Securities, Units of UTI, Commercial Papers, Certificates of Deposits, floating rate bonds, etc. The members can trade on their own behalf as well as on behalf of their clients.

ii) **Capital Market Segment:** This segment deals with equities and retail trade in convertible or non-convertible debentures and hybrids. The securities of medium and large companies with nation-wide investor base are dealt with Securities which are traded on other Stock Exchanges can also be traded at NSE.

National Stock Exchange has fully automated screen-based trading system. It is connected through a Very Small earth-based Aperture Terminal (VSAT) or through leased telephone lines. Every member of the NSE trades with other members through a computer located at his office, anywhere in India. Satellite lines are established between the computers of members using VSAT. Through this computer network, all members receive complete market information about a particular share and the company.

For undertaking a transaction, a trading member will enter the order and can specify the conditions for sale/purchase. For example, he may specify the limit on the price, or may state that order be matched at the best price available or at a price better than specified by him. He will also specify the period for which his order will be valid. The NSE computer system will match the order, i.e. the order for purchase of a specific security at a certain price will be matched with another order to sell the same security at the same price, etc. The system does not disclose the identity of one-trading member to the other one.

Check Your Progress 2

1) What do you understand by Rolling Settlement System? Explain its advantages.

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2) What is dematerialisation of securities? What are its advantages?

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3) What are the special features of National Stock Exchange? Explain its trading system.

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9.8 OVER THE COUNTER EXCHANGE OF INDIA (OTCEI)

OTCEI is also a totally computerised, ringless, screen based, automated stock exchange. It was established as a company under section 25 of the Companies Act in 1990 by eight financial institutions. The main objective of its establishment was to help enterprising promoters to set up their projects by raising capital from the market easily and cheaply.

A company, whose security is to be transacted at OTCEI, must be sponsored by a sponsor. A financial institution, mutual fund, scheduled bank, its subsidiary and merchant banker approved by SEBI may be the sponsor. They are high net worth entities. Small and medium sized companies which are unable to meet the listing requirements of other Stock Exchanges (e.g. minimum capital requirement of Rs. 3 crore) can be sponsored by any of the sponsors at the OTCEI, if they have issued capital of Rs. 30 lakhs and above.

The sponsor-member is also required to give two-way quotes for the scrip (i.e. the price at which they are ready to buy and to sell the security of the sponsored company) for at least 18 months. In addition, there may be another market maker giving two-way quotes for the scrip. The basic objective is to create confidence of the investors in the security and to keep narrow spread between the two prices.

Trading in securities is undertaken through a network of members and dealers who are spread all over the country. Any individual firm or company may be the dealer, who operate OTCEI counter that is linked to the Central OTCEI computer network. They can also perform market making for the companies. The investors can see on the dealer's computer screen the quotations for any security before placing an order. After the order is placed and matched, confirmation slips are generated by the computers, which give full details of the transaction. The OTCEI follows T+5 rolling settlement system for listed securities and weekly settlement system for permitted securities.

Thus, OTCEI provides the companies nation-wide trading of their securities and encourages new and small entrepreneurs in raising funds for their companies. For the investors, there is complete transparency in the deals, transactions are fast, and liquidity is provided by the two-way quotes given by the sponsors.

Besides, the securities which are listed at the OTCEI, (and which cannot be transacted at any other stock exchange) certain shares/debentures listed at other stock exchange and units of UTI and Mutual Funds are allowed to be transacted at OTCEI. These are called **'Permitted Securities'**.

9.9 TRADING IN DERIVATIVES

A significant development in the Indian stock market during recent years (2000-01) has been the introduction of trading in equity derivatives at the stock exchanges. Derivative product which are permitted to be transacted include both *options* and *futures* on both *equity index* and on *individual stocks*. Thus, there are four equity derivative products available in Indian stock markets.

The introduction of trading in equity derivatives was recommended by the L. C. Gupta Committee on derivatives, primarily to provide hedging facility against market risk to the equity holders. Besides, it will also increase the efficiency and liquidity of the cash market in equities through arbitrage transactions.

The term derivative indicates that it has no independence value of its own. Its value is derived from the value of some other asset, particularly a financial asset.

Derivatives are broadly classified into futures and options. **Future Contracts** are agreements to buy or sell a fixed number of a particular security for delivery at a fixed date in the future at a fixed price. It involves a definite purchase or sale at a future date. The price at which the security will be transacted in future is decided at the time of entering the future contract. At National Stock Exchange and Bombay Stock Exchange, future contracts at one month, two-month and three-month period are allowed and the same expire on the last Friday of the month concerned. Both the parties are required to fulfil the terms of the contract.

Options contracts are contracts, which give the holder the right (but not the obligation) to buy or to sell securities at a pre-determined price within or at the end of a specified period. **Expiration date** is the day on which the option contract matures. The right to buy is called the **call option** and the right to sell is called the **put Option**. The price at which an option can be exercised is called the **exercise price.**

The person who buys (a put option or a call option, i.e. the right to sell or to buy respectively) is called the buyer of the option. The other party which provides this option to the option buyer is called the **option writer**. The buyer of option (who is also called as option holder) has to pay option premium to the option writer for acquiring the right. The premium is a one-time outflow for the buyer of options.

The buyer of an option is not under an obligation to buy or sell at the exercise price. He will do so, if it is beneficial to him, otherwise he would like the option to lapse (i.e. he

will not exercise his right to buy or sell). In such cases, he will only loose the premium, which he has paid at the time of entering into the option contract. For example, A buys a call option from X for one share of Y Company at a premium of Rs. 100, with an exercise price of Rs. 4500 with a maturity of one-month. The current market price is Rs. 4200. If a month latter the price of the share goes upto Rs. 4800/-, the buyer will earn a profit of Rs. 200 (i.e. Rs. 4800 – 4500-100), if he chooses to exercise the option. The seller will loose Rs. 200/- . Thus, the risk of the buyer of call option is restricted to Rs. 100/-, which is the amount of the premium paid by him, while his gain will be unlimited (i.e. depends upon the price at the time of maturity of the contract). The risk for the option writer is unlimited while his gain is restricted to the amount of premium received. The premium amount varies according to market conditions.

A derivative trading in India has been allowed in- (i) Index Futures (ii) Index Options, (iii) Individual Futures and (iv) Individual Options at National Stock Exchange and Bombay Stock Exchange. The index used for this purpose is NIFTY and SENSEX. NIFTY is the index of 50 share prices transacted at National Stock Exchange while SENSEX is the index of 30 shares prices transacted at Bombay Stock Exchange. The combined turnover in the four derivative products (stated above) traded at NSE amounted to Rs. 8700 crore, which rose to Rs. 12919 crore in November, 2001.

Check Your Progress 3

1) What is OTCEI? What are its objectives?

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2) What do you understand by Derivatives?

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3) Discuss the procedure adopted for undertaking a transaction in option.

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9.10 LET US SUM UP

The Secondary Market is the market which deals in trading of shares, bonds, debentures and other securities. The floating, subscription and issuing of these securities is also called **'stock market'.** The growth and development of the primary market depends to a significant extent upon the vibrant secondary market.

The market where securities are traded is called **Stock Exchange**. Presently, there are 23 Stock Exchanges in India. Stock Exchanges have two types of trading system:

(i) Traditional trading system and (ii) On-line trading system.

The settlement of transaction in specified securities is done at the end of each settlement period of two weeks. In case of non-specified securities only money part is handled by the clearing house payment. Actual delivery of securities is handled by the members themselves. The carry forward system (badla) has been replaced by the Rolling Settlement System since January, 1998.

Several reforms have been introduced in the area of transfer of shares. These include the introduction of dematerialisation of securities, incorporation of National Stock Exchange in 1992, establishment of over the Counter Exchange of India (OTCEI) under Section 25 of the Companies Act, introduction of trading in equity derivatives at the Stock Exchanges etc.

The derivative trading in India has been allowed both in Index Futures and options and individual futures and options at National Stock Exchange and Bombay Stock Exchange.

9.11 KEY WORDS

Bonds : Bond is a security issued by a company, financial institution or Government, which offers regular payment of interest at fixed rates.

Boom : A condition of the market denoting increased activity with rising prices and higher volume of the business resulting from greater demand of securities.

Broker : A broker is one who performs various functions in organised security markets. He arranges transactions at the stock exchange.

The broker performs all these functions for commission called brokerage.

Buyback : The arrangement agreed to between the company and its investors to buy back the securities for a specific price.

Call Option : The right to buy as above is called call option.

Capital Market : It is essentially the long-term market for securities and loanable funds.

Coupon Rate : It is the rate of interest, which the issuer pays on the principal/paid up value of the bond. It is fixed at the time of issuance of the bond.

Debenture : There is no conceptual difference between a bond and a debenture. The term 'debenture' is generally used with reference to business, trade and industrial loans of the private sector. The term 'bond' is commonly used in connection with borrowing of the public sector including that of the Central Government.

Deep Discount Bonds : This bond is issued at a discount on the face value. The face value is paid at the maturity. These bonds are also known as zero coupon bonds.

Dematerialisation : Securities do not exist in physical form i.e. in the shape of share certificates. Instead of holding of securities by an investor is recorded electronically by the Securities Depository. Any transaction undertaken by the investor is recorded in the books of the Depository and no physical delivery of the security is neither taken nor given.

Derivatives : Derivatives are those products, which have no independent value of its own. It's value is derived from the value of some other asset

underlying it. For example, in case of individual share derivative its value depends upon the value of the share concerned.

Dividend : It is the share of profit that is paid to the shareholders.

Future Contracts : These are agreements to buy/sell a fixed number of a particular security for delivery at a fixed date in the future at a fixed price.

Gilts : Fixed interest rate securities by the government to raise money for public expenditure in India by auction process.

Going Public : It implies that an existing firm becomes a corporation and raises funds from the public through new issues.

Listed Securities : These are those securities that appear on the approved list of a stock exchange. These securities are also called 'quoted' securities.

Options : Option is a contract, which gives the hold the right to buy or to sell securities at pre-determined price within or at the end of a specified period. There is no obligation to buy/sell.

Over the Counter Negotiation : Some times, the transactions in securities are negotiated by a direct interaction between the concerned brokers acting on behalf of the buyers as well as sellers. Such a method of transaction is known as 'over the counter' trading in securities. In this method of transaction, the stock exchange does not pay any role.

Put Option : The right to sell as above is called put option.

Split : Sub division of shares of large denomination into shares of smaller denomination. Also means subdivision of holding.

Stag : An applicant for a new issue of shares that hopes to sell the shares on allotment at a profit once trading commences in the secondary market. A speculator is one who buys and sells stocks rapidly for last profits.

Stock Exchange : It is a recognised organization that supervises the transactions in 'listed' securities only.

Volatility : A measure of the price movement of a security during a specific period.

9.12 SOME USEFUL BOOKS

Auerbunch, R. D. (1983): *Financial Markets and Institutions,* Macmillan Publishing Co. Inc., New York..

Bhole, L. M. (1999): *Financial Institutions and Market,* Tata Mc Graw Publishing Company Ltd., New Delhi.

Gupta, S. B. (1995): *Monetary Economics-Institutions, Theory and Policy,* S. Chand & Company Ltd., New Delhi.

Khan, M. Y. (1985): *Indian Financial System: Theory and Practice,* Vikas Publishing House Private Ltd., New Delhi.

Varshney P. N. and Mittal D.K. (2002 Edition): *Indian Fianncial System,* Sultan, Chand & Sons, New Delhi.

9.13 ANSWERS/HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) Stock Exchange refers to the market where securities are traded. The Securities and Exchange Board of India (SEBI) regulates and controls the Stock Exchanges.

2) Dealings of securities on the trading floor of the Stock Exchanges through the brokers is traditional system at Stock Exchanges.

3) Transaction of securities business through computers (linked with the main computer of the Stock Exchanges through VSATs) by the brokers is called as 'on-line Trading System'. The advantages of on-line trading system are:

   i) Securities market is made more transparent, (ii) Very convenient, fast and efficient, (iii) Easy access to large number of customers/dealers.

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Check Your Progress 2

1) Rolling Settlement System refers to a method of settlement of transactions on a voluntary basis on the stock exchanges for securities eligible for demat trading. The advantages of this system are:

   i) speedy disposal of payment and delivery of securities,

   ii) enhancement of efficiency and integrity in the securities market.

2) Dematerialisation of securities means holding of securities only in the recorded forms instead of holding in physical forms i.e. in the form of share/ bond certificates. Its advantages are:

   i) Avoiding the problem of loss in transit, (ii) Getting rid of arbitrary power of the companies in refusing the transfer,

   iii) Solution of the problem of delivery.

3) See Section 9.7

Check Your Progress 3

1) OTCEI, namely Over The Counter Exchange of India (OTCEI) is computerised, screen based, automated Stock Exchange established under Section 25 of the Companies Act. It aims to help the enterprise to set up their projects by raising capital from the market easily and cheaply through sponsorship by a financial institution.

2) Derivatives refer to the products, which have no independent value of its own. Its value is derived from the value of some other asset underlying it.

3) See Section 9.9

UNIT 10 REGULATORY FRAMEWORK FOR CAPITAL MARKET

Structure

10.0 Objectives
10.1 Introduction
10.2 Functions of SEBI
10.3 Powers of SEBI under Securities and Exchange Board of India Act, 1992
10.4 SEBI's Powers Under Securities Contracts (Regulation) Act, 1956
10.5 Organisational Set Up of SEBI
10.6 Guidelines for Disclosure and Investor's Protection
10.7 Free Pricing of New Issues
10.8 Entry Norms for New Issues
10.9 Primary Capital Market Reforms
10.10 Secondary Market Reforms
10.11 Regulation Over Insider Trading
10.12 Regulation Over Security Depositories and Participants
10.13 Substantial Acquisition of Shares and Take-Overs
10.14 Let Us Sum Up
10.15 Key Words
10.16 Some Useful Books
10.17 Answers/Hints to Check Your Progress

10.0 OBJECTIVES

After reading this Unit, you will be able to :

- familiarise yourself with the regulatory framework governing the capital market in India,
- describe the statutory powers vested with SEBI as regulatory authority,
- state the norms for free pricing of new issues and entry for new issues,
- discuss the reforms introduced in the primary and secondary capital market, and
- summarise regulatory measures over insider trading.

10.1 INTRODUCTION

We have learned in Unit 8 and 9 that several reforms have been introduced in both segments of capital market, namely primary market and secondary market. Keeping in view the role and significance of capital market in the economy and the volatile nature of reforms in general, and in the context of globalisation of economy in the particular, the regulation of the capital market is highly needed. Both these segments

and various participants therein are at present within the purview of a single regulatory authority i.e., the Securities and Exchange Board of India (SEBI). SEBI came into existence through a Resolution of the Government of India dated 12th April, 1988. Later, it acquired statutory recognition and status after the enactment of the Securities and Exchange Board of India Act, 1992.

SEBI has been constituted as a corporate body, having perpetual succession and a common seal. It consists of a chairman, two members each from amongst the officials of the Government of India and the Reserve Bank of India, besides two other members appointed by the Government of India.

10.2 FUNCTIONS OF SEBI

SEBI has been designated as the sole regulatory authority over the securities market. It has been entrusted with the duty –

i) to protect the interests of investors in securities,

ii) to promote the development of and securities market, and

iii) to regulate the securities market.

Thus **SEBI** is not only a regulator, but is also a promoter of the securities market. Section 11 (2) of the Act outlines the regulatory activities of the Board as follows:

a) Regulating the business in stock exchanges and any other securities markets.

b) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisors and such other intermediaries who may be associated with securities markets in any manner.

c) Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies, and any other intermediaries.

d) Registering and regulating the working of venture capital funds and collective investment schemes including the mutual funds.

e) Promoting and regulating self-regulatory organisations.

f) Prohibiting fraudulent and unfair trade practices relating to securities markets.

g) Promoting investors' education and training of intermediaries of securities markets.

h) Prohibiting insider trading in securities.

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

j) Calling for information from companies, undertaking inspection, conducting inquiries and audit of the stock exchanges, mutual funds and other persons associated with the securities markets and intermediaries, and self-regulatory organisations in the securities market.

k) Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act 1956 as may be delegated to it by the Central Government.

l) Levying fees and other charges for carrying out the purposes of Section 11.

m) Conducting research for the above purposes.

n) Calling from or furnishing to any such agencies, as may be specified by the Board, such information, as may be considered necessary by it for the efficient discharge of its functions.

o) Performing such other functions as may be prescribed.

10.3 POWERS OF SEBI UNDER THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

Securities and Exchange Board of India has been conferred the following powers under the SEBI Act:

i) **Power to Grant Registration Certificates to Intermediaries**

Section 12 of the Act provides for compulsory registration of the various intermediaries associated with the securities market. Hence all intermediaries, namely, stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment advisor, depository participant, custodian of securities, foreign institutional investor, credit rating agency and any other agency are required to buy, sell, or deal in securities in accordance with the conditions of a certificate of registration granted by SEBI.

SEBI is also empowered to suspend or cancel a certificate of registration after giving the person concerned a reasonable opportunity of being heard.

ii) **Registration of Venture Capital Funds and Collective Investment Schemes**

The Act requires a certificate of registration to be obtained from SEBI for sponsoring or carrying on any Venture Capital Fund and Collective Investment Scheme including Mutual Fund.

iii) **Power to Issue Directives to Intermediaries**

The Act confers upon SEBI powers to issue directions to any person or class of persons mentioned in (1) above, or who may be associated with the securities market, if SEBI is satisfied that such directions are necessary –

a) in the interest of investors, or orderly development of the securities market, or

b) to prevent the affairs of any of the above mentioned intermediaries/persons, being conducted in a manner detrimental to the interests of investors or securities market, or

c) to secure proper management of any such intermediary or person.

iv) **Power to issue Directions to Companies**

For the protection of investors, the Board may specify the matters relating to issue of capital, transfer of securities and other matters incidental thereto, which shall be disclosed by the companies and also the manner in which to be disclosed.

v) **Power to Impose Penalties**

The Board may appoint any of its senior officers as Adjudicating Officer for holding an enquiry into various defaults and offences under the Act and for imposing penalties. Monetary penalties may be imposed on capital market intermediaries and other participants for a listed range of violations. An Appellate Tribunal may also be set up to hear appeals against the decisions of the adjudicating authority.

vi) **Power to Investigate into Irregularities**

SEBI possesses the power to investigate into irregularities and for this purpose it may summon the attendance of, and call for documents from all categories of market intermediaries, including persons in the securities market. SEBI is also empowered to issue directions to the aforesaid persons

with a view to protect investors or securing the orderly development of the securities market.

10.4 SEBI'S POWERS UNDER SECURITIES CONTRACTS (REGULATION) ACT, 1956

The following powers vested with the Government under the Securities Contracts (Regulation) Act, 1956 shall also be exercisable by SEBI to ensure more effective protection of the interests of investors and to create an efficient and well regulated stock market:

i) **Recognition of Stock Exchanges**

A stock exchange may be recognised by SEBI, if it is satisfied that –

a) the rules and bye-laws of the stock exchange are in conformity with the conditions prescribed to ensure fair dealings and to protect investors, and

b) the stock exchange is willing to comply with any other conditions which may be imposed by the Government for carrying out the objectives of the Act.

The recognition may be granted subject to imposition of certain conditions also regarding qualifications of members, manner of entering contracts, representation of the government and maintenance of accounts. A stock exchange other than a recognised stock exchange is prohibited to function.

Every recognised stock exchange shall furnish to SEBI periodical returns regarding its affairs. SEBI is also authorised to appoint one/more person(s) to make an enquiry in relation to the affairs of the governing body of the stock exchange or any of its members.

SEBI is authorised to withdraw recognition granted to a stock exchange in the interest of the trade or in the public interest. It may supersede the Governing Body of a stock exchange and may appoint any person/persons to exercise all the powers and perform duties of the governing body. It is authorised to direct a recognised stock exchange to suspend its business for a period upto seven days in case an emergency arises. The period of suspension may also be extended.

SEBI also enjoys the authority to approve the bye-laws of the stock exchange or to make such bye-laws. A stock exchange may also establish additional trading floor with the prior permission of SEBI. The Central Government/

SEBI is authorised to prohibit the sale or purchase of any specified security, except with the permission of the Central Government, in order to prevent undesirable speculation in that security/securities in any state/area.

ii) **Listing of Securities**

Where securities are listed on the application of any person in any recognised stock exchange, such person is required to comply with the conditions of the listing agreement with that stock exchange.

A stock exchange may refuse to list the securities of any public company in accordance with the powers vested in it in its bye-laws. The company may in that case appeal to the Central Government, whose decision shall be final.

10.5 ORGANISATIONAL SET-UP OF SEBI

To exercise its powers and perform its functions, SEBI has set up the following Departments:

i) **Primary Market Department**

This department looks after all policy matters and regulatory issues for primary market, registration, regulation and monitoring of merchant bankers, portfolio management services, investment advisors, debenture trustees, etc.

ii) **Issue Management and Intermediation Department**

This department vets prospectus, letters of offers for public and right issues, coordinates with primary market policy for framing rules, issues guidance notes and clarifications, etc.

iii) **Secondary Market Department** (Policy, Operating and Exchange Administration New Investment Products, Insider Trading)

This department is responsible for all policy and regulatory issues for secondary markets, and new investment products, registration and monitoring of stock exchanges.

iv) **Secondary Market Department** (Exchange Administration, Inspection and Non-Member Intermediaries).

v) Institutional Investment Department (Mutual funds and Foreign Institutional Investment).

This department is responsible for policy, registration, regulation and monitoring of foreign institutional investors, domestic mutual funds, policy and regulation of substantial acquisition of shares.

Check Your Progress 1

1) Give three important regulatory functions and three promotional functions of SEBI as given in the SEBI Act, 1992.

2) Name the intermediaries who are regulated by SEBI under the SEBI Act, 1992.

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3) Identify the powers of SEBI to issue directives to the intermediaries and the companies.

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4) Explain the provisions regarding recognition of Stock Exchanges by SEBI.

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10.6 GUIDELINES FOR DISCLOSURE AND INVESTOR'S PROTECTION

The Securities and Exchange Board of India issued these guidelines in June, 1992 after the Capital Issues (Control) Act, 1947 was repealed. These guidelines, apply to all issues made subsequently. In these guidelines, SEBI has permitted certain categories of companies to fix the premium on new issues of shares themselves. Moreover, the guidelines require the issuer (companies) to disclose full facts and particulars to the intending investors in their offer documents and also prescribe other rules in connection with the issue of shares, which we shall study subsequently.

10.7 FREE PRICING OF NEW ISSUES

These guidelines have categorised the companies going for public issues into three categories. Within each category, companies fulfilling certain conditions are allowed to fix the premium freely and the rest are permitted to issue shares at par only:

i) new companies,

ii) existing private/closely held companies

iii) existing listed companies

i) **First Issue of New Companies**

A new company is one, which has not completed 12 months of commercial operations and its audited results are not yet available. If a new company is set up by entrepreneurs without a track record, it will issue capital to public only at par.

But, if a new company is being set up by an existing company with a five year track record of consistent profitability, it will be free to price its issue, provided the promoting company contributes 50% of the equity of the new company. The issue price is made applicable to all new investors uniformly and the prospectus contains justification for issue price. If more than one company promotes a new company, each of them must fulfil the profitability criterion, i.e., profits must exist in five out of seven preceding years with profits in the last two years.

ii) **First Issue by Existing Closely Held Unlisted Companies**

Such companies with a three year track record of consistent profitability are permitted to freely price the issue of the share and list the securities on the stock exchanges. Three years track record means profits in three out of preceding five years with profits during the last two years prior to the issue. In case of public sector banks, the track record of consistent profitability should be for two years only.

A company which does not have three years track record of consistent profitability, can issue capital to public for raising additional capital only at par provided not less than 20% of the total issued capital (expended capital) is offered to public.

A company without a three year track record of consistents profitability, which has been promoted by other company/ companies with a five years track record of consistent profitability will have the freedom to price the share, provided the promoting company/companies contribute not less than 50% of the total issued capital subject to lock-in-period.

The pricing will be determined by the issuer and the lead managers to the issue and would be subject to specific disclosure requirements including –

a) disclosure of the net asset value of the company as per the last audited balance sheet, and

b) justification for the issue price.

iii) **Public Issue by Existing Listed Companies**

These companies are allowed to raise fresh capital by freely pricing their further issues. The issue price will be determined by the issuer in consultation with the lead managers to the issue. The prospectus or offer document should contain the net asset value of the company and a justification for the price of the issue. High and Low prices of the shares for the last two years should also be mentioned.

10.8 ENTRY NORMS FOR NEW ISSUES

In order to improve the quality of paper entering the primary market, SEBI introduced a very effective regulatory step by prescribing the entry norms for the issuer companies. The guidelines issued by SEBI on April 16, 1996 as subsequently amended, are as follows:

i) No company, intending to get its securities listed on any stock exchange, shall make the first offer to the public of equity or bonds convertible into equity, unless it has a track record of dividend payment in immediately preceding three years. By track record of dividend payment is meant that dividend has been declared in each of the three years.

ii) If the company is a manufacturing company and does not satisfy (i) above, it can make for the first time an offer only if –

   a) a scheduled bank or a public financial institution has appraised the project to be financed through the public issue, and

   b) the bank/public financial institution is partly financing the project by way of loan/equity to the extent of 10% of the project cost.

   This condition has been extended to the services sector also.

iii) An existing company, whose securities are listed on any stock exchange, shall have to satisfy either of the above conditions (i.e. (i) or (ii) above) before the public issue, if its net worth, after the offer to the public, becomes more than five times the net worth prior to such offer.

iv) The above entry norms will not apply to the public sector banks. If they want to issue capital at a premium, two years profitability record will be sufficient as against three years' requirement for others. New private sector banks are allowed issues at par.

In June 2000, the SEBI further tightened the entry norms for IPOs as follows:

a) IPO of size upto 5 times the pre-issue networth is allowed

only if the company has a record of profitability and networth as specified above.

b) Companies without such track record or the issue size beyond 5 times the pre-issue networth are allowed to make IPOs only through the Book Building route and 60% of the issue to be allotted to qualified institutional borrowers.

v) The above entry norms are also not applicable to offer for sale/bought out deals to be listed on the OTCEI, provided these were registered with OTCEI on or before April 16, 1996.

In March 1999, SEBI relaxed entry norm (No. (i) above) by changing the requirement of actual payment of dividend in three years to 'ability to pay dividend' in terms of Section 205 of the Companies Act, 1956. In such cases, an additional requirement has also been prescribed for the companies intending to come out with an initial public issue based on ability to pay dividend i.e., they should have a minimum pre-issue net worth of not less than Rs. 1 crore in three out of the preceding five years, with a minimum net-worth to be met during the immediately preceding two years.

10.9 PRIMARY CAPITAL MARKET REFORMS

Following the acquisition of statutory status by SEBI and enhancement of its powers, the Securities and Exchange Board of India has introduced a number of regulatory measures with the object to reform the capital market and to protect the investors' interest. In this section, we shall deal with the various regulatory steps undertaken by SEBI in the primary new issues market.

i) **Regulation over Intermediaries**

All intermediaries in the primary and secondary markets have been brought under the SEBI's regulatory purview for the first time. SEBI has notified rules and regulations for the intermediaries, namely, merchant bankers, brokers and sub-brokers, portfolio managers, underwriters, registrars, share transfer agents, etc. These rules and regulations prescribe, besides others, for their registration with SEBI, capital adequacy norms, obligations and responsibilities, procedure for inspection by SEBI and action to be taken against defaulting intermediaries. They have to abide by the Code of Conduct prescribed for them.

The multiple categories of merchant bankers have been abolished and replaced by a single category. Moreover, only corporates are allowed to function as Merchant Bankers. Merchant Bankers are permitted to carry out issue

management activity only and are prohibited from undertaking any fund-based activity such as acceptance of deposits, leasing and bills discounting. They are required to acquire a certificate granted by SEBI for carrying on their business. The registration can be suspended or cancelled by SEBI if it decides to do so. Separate rules and regulations have been prescribed by SEBI for registrars to issue and share transfer agents, stock brokers and sub-brokers, portfolio managers, etc. Thus all these intermediaries are within the regulatory supervision of SEBI. The latter is vested with the powers to take action against them if defaults/ irregularities are noticed in their functioning.

ii) **Disclosures in Offer Documents**

To enable the investors to make informed investment decisions based on full transparency of facts, SEBI has issued detailed guidelines for the disclosures of full facts in the Prospectus/offer documents by the issuer companies. The latter are required to disclose all material facts and specify the risk factors associated with their projects, while making public issues. In case of the existing companies, financial performance of the company for the last five years, along with justification of premium and risk factors and management perception of risk factors are also required to be published in the prospectus/offer document.

Though the Public Issue offer document is now not vetted by **SEBI**, a draft prospectus/offer document is filed with SEBI, and it is deemed as a public document. Merchant bankers are required to file its copies with stock exchanges where the shares are proposed to be listed. Copies are also to be made available to the public. Thus the prospectus/ offer document is made available for scrutiny by all concerned before its finalisation. Lead Manager to the issue is required to give a due diligence certificate regarding disclosures made in the offer document. Such certificate will be a part of the offer document itself for better accountability and transparency on the part of the Lead Manager.

iii) **Code of Advertisement**

SEBI has issued a code of advertisement for public issues to ensure that the advertisement is truthful, fair and clear, and does not contain any statement which is untrue or misleading. It shall be the responsibility of the Lead Manager to ensure strict compliance with the code of advertisement by the issuer company.

iv) **Underwriting**

Underwriting of new issues is not mandatory since 1994. If the issue is underwritten, the Lead managers must satisfy

themselves about the net worth of the underwriters and the outstanding commitments and disclose the same to SEBI.

If the issue is not underwritten and the company is unable to collect 90% of the amount offered to the public, or if the issue is underwritten and the company is unable to receive 90% of issued amount from public subscription plus accepted devolvement from underwriters, within 60 days from the closure of the issue, the company shall refund the full subscription amount. Minimum subscription clause is applicable to both public and right issues and not to offer of sale of securities.

v) **Allotment of Securities**

The following rules have been laid down in connection with allotment of securities:

a) The minimum percentage of securities to be issued to the public for the purpose of listing was reduced from 60% to 25%.

b) Allotment procedure was revised to introduce the requirement that shares be allotted on a pro-rata basis.

c) A norm of five shareholders for every Rs. 1 lakh of fresh issue of capital and ten shareholders for every Rs. 1 lakh of offer for sale was prescribed as an initial and continuing listing requirement.

d) Payment of any direct or indirect discounts or commissions to persons receiving firm allotment has been prohibited.

e) The practice of making preferential allotment of shares at prices unrelated to the prevailing market prices has been stopped and fresh guidelines issued by SEBI in this regard. Issue of shares on a preferential basis can be made at a price not less than the higher of the following:

average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during six months preceding the relevant date

OR

the average of the weekly high and low of the closing prices of the share during the two weeks preceding the relevant date.

f) A system of appointing SEBI representatives to supervise the allotment process was introduced to minimise malpractices in allotment of over-subscribed public issues.

g) Public Sector bonds are now within the regulatory authority of SEBI.

Check Your Progress 2

1) Fill up in the blanks:

   i) Under the new guidelines issued by SEBI relating to free pricing of new issues the companies have been divided into .... categories for public issues.

   ii) Existing private companies having .... year track record of consistent profitability are permitted to freely price the issue of share and list the securities on the stock exchanges.

2) State true or false:

   i) All intermediaries in the primary and secondary markets have been brought under the SEBI regulation. (T/F)

   ii) Lead Manager is not required to give a due diligence certificate regarding disclosures made in the offer document. (T/F)

   iii) The minimum percentage of securities to be issued to the public for the purpose of listing has been reduced from 60% to 25%. (T/F)

10.10 SECONDARY MARKET REFORMS

The Securities and Exchange Board of India has undertaken a number of measures for streamlining the functioning of the secondary market. These measures aim at improving market efficiency, making stock market transactions more transparent, curbing unfair trade practices and bringing capital market upto international standard.

i) **Regulation over Stock Exchanges**

As already noted, the Government of India delegated its powers to SEBI to regulate the Stock Exchanges. SEBI directed the Stock Exchanges to broad base their Governing Boards and change the composition of their arbitration, default and disciplinary committees. The Governing Board should comprise of equal number of elected stockbroker directors and SEBI/Government nominees. Representation of stockbroker directors shall be limited to 40 percent on the disciplinary committee.

SEBI has commenced inspecting the affairs of Stock Exchanges and enquiries have been ordered into the affairs of their Governing Boards.

ii) **Capital Adequacy Norms for Brokers**

SEBI has prescribed capital adequacy norms for brokers so as to ensure that such brokers' firms are adequately

capitalised in relation to their outstanding position. These norms prescribe a base Minimum Capital plus additional capital related to the volume of business. Stock Exchanges have amended their bye-laws in this regard.

iii) **Transparency in Client-broker Relationship**

SEBI has made it mandatory for brokers to maintain separate accounts for their clients and for themselves. They must disclose the transactions price and brokerage separately in the contract notes issued to their clients. Brokers must get their account books audited and the audit report filed with SEBI. Contract notes are to be issued within 24 hours.

iv) **Revision of Listing Agreements**

SEBI advised the Stock Exchanges to amend the listing agreements to ensure that a listed company furnishes annual statement to the Stock Exchanges showing variations between financial projections and projected utilisation of funds made in the offer documents and actuals. Thus, the shareholders can make a comparison between promises and performance.

10.11 REGULATION OVER INSIDER TRADING

With a view to ensure fairness in securities trading, and to eliminate the ill effects of insider trading, SEBI framed SEBI (Insider Trading) Regulations in 1992. According to these regulations an insider is prohibited from:

a) dealing either on his own behalf or on behalf of any other person in securities of a company, listed on any stock exchange on the basis of any unpublished price sensitive information, or

b) communicate any unpublished price sensitive information to any person, except as required in the ordinary course of business or under any law, or

c) counsel any other person to deal in securities of any company on the basis of unpublished price sensitive information.

Unpublished Price Sensitive information is defined, as any information, which relates to the following matters and is generally not published by the company for general information, but which, if published or because known, is likely to materially affect the price of the securities in the market.

i) financial results,

ii) intended declaration of dividends,

iii) issue of bonus, right shares,

iv) any major expansion plan/execution of new projects,

v) amalgamations, mergers, take-overs,

vi) disposal of undertaking, and

vii) any change in policies, plans or operations of the company.

An insider is a person who is or was connected with the company and is reasonably expected to have access to unpublished price sensitive information.

Any insider who contravenes any of the above provisions will be guilty of Insider Trading. SEBI has the power to investigate into and inspect the books of accounts, either records or documents of an insider upon receipt of any complaint-alleging insider trading, or upon its own knowledge and information. On the basis of the investigation report, SEBI may give necessary directions to the insider to protect the interest of investors as well as of securities market.

10.12 REGULATION OVER SECURITY DEPOSITORIES AND PARTICIPANTS

The Securities Depositories and the participants have also been brought within the regulatory authority of SEBI. It has made SEBI (Depositories and Participants) Regulations in 1996. The salient features of these regulations are as follows:

i) A securities depository may be sponsored by any one of the followings, namely, a public financial institution, a scheduled bank, a foreign bank, a recognised stock exchange, a financial services company (at least 75% of its capital must be held by the above mentioned institutions jointly or severally), a foreign company providing custodial, clearing or settlement services in securities market and foreign financial services company approved by the Central Government.

ii) The sponsor shall hold at least 51% of the equity capital of the depository. The balance shall be held by participants. No participant shall hold more than 5% of the equity capital of the depository.

iii) A certificate of registration and a certificate of commencement of business must be obtained by the sponsor from SEBI.

iv) The depository must have a net worth of not less than Rs.100 crores and must have established the infrastructure facilities and systems.

v) The participants are required to obtain a certificate of registration from SEBI, which shall be valid for a period of five years and may be renewed thereafter. Besides, the institutions mentioned in (i) above, a clearing corporation (or a clearing house) of a stock exchange, a stock broker (with minimum net worth of Rs.50 lakhs), and a non-banking finance company (with minimum net worth of Rs.50 lakhs) may also apply for registration as participant.

vi) SEBI has the right to undertake inspection of the books of accounts, records, documents, infrastructure, systems and procedures or to investigate the affairs of a depository, a participant, a beneficial owner, an issuer or its agent.

vii) SEBI possesses the power to suspend the certificate of registration granted to a depository or a participant if it contravenes any provision or defaults otherwise.

viii) SEBI may cancel the certificate of registration granted to a depository or participant if:

a) it is guilty of fraud, or has been convicted of an offence involving moral turpitude, or

b) has been guilty of repeated defaults.

SEBI has taken several initiatives to promote dematerialised or paperless trading. SEBI has introduced compulsory trading in shares in dematerialised form in specified scripts by institutional investors (i.e. mutual funds, banks, financial institutions and foreign institutional investors) with effect from January 15, 1998. The list of shares for compulsory dematerialising trading is gradually expanding.

10.13 SUBSTANTIAL ACQUISITION OF SHARES AND TAKE-OVERS

Substantial acquisition of shares and take-over have been brought within the regulatory umbrella of the SEBI. It has issued SEBI (Substantial Acquisition of Shares and Take-over) Regulations, which provide a transparent process to be followed by the acquirer of the shares. Its main objective is to protect the interest of minority shareholders. The main features of these Regulations are as follows:

i) Every shareholder holding more than 10% shares of a company or voting rights or having control over the company shall have to declare to the company the number and percentage of shares held by him.

ii) An acquirer, who wants to acquire shares/voting rights/ control (which alongwith his existing voting rights/shares shall exceed 10% of the shares of the company), shall have to make a public announcement through advertisement in

newspapers to acquire shares. A copy of the public announcement shall be sent to SEBI and all stock exchanges where the shares are listed. A letter of offer shall also be sent to the SEBI, who may suggest changes therein. Thereafter it is sent to the shareholders of the Company concerned.

iii) The offer to acquire the shares shall be made at a minimum offer price, which shall be fixed in the manner prescribed.

iv) The public offer shall be made to the shareholders of the target company to acquire from them an aggregate minimum of 20% of the voting capital of the company.

v) Any other person who is desirous of making any offer shall, within 21 days of public announcement of the first offer, make a public announcement of his offer for acquisition of the shares of the same target company.

vi) Upon the public announcement of the competitive bid/bids, the first acquirer shall have the option to announce:

(a) a revision of the offer, or

(b) withdrawal of the offer with the prior approval of the Board.

vii) By way of security for performance of his obligations under the regulations, the acquirer shall deposit in an escrow account the sum which will be 25%, if the consideration payable is upto Rs. 100 crore and 10% thereafter.

vii) Within thirty days after the closure of offer, the acquirer shall make payment for shares offered for sale.

Check Your Progress 3

1) What do you understand by Insider Trading? What regulation has been imposed on it by SEBI?

....

....

....

2) List three salient features of regulation over securities depositories.

....

....

....

3) Which option can the acquirer have upon the public announcement of the competitive bid?

....

....

....

10.14 LET US SUM UP

The primary market and secondary market and the various participants are regulated by Security and Exchange Board of India (SEBI). It has been given the statutory recognition under Securities and Exchange Board of India, Act, 1992. On the one hand, it protects the interests of investors in securities through various regulatory measure, on the other hand, it also promotes the development of securities market. SEBI has been conferred the powers to grant registration certificates to intermediaries and issue directives to them and the companies. It also has the powers to investigate into irregularities and impose the penalties.

Securities and Exchange Board of India has brought about reforms in the new issues market by issuing guidelines for disclosure and Investor Protection, pricing of new issues by companies, entry norms for new issues. SEBI has also taken various steps for reforms in the primary new issues market. All these measures have been duly discussed.

SEBI has made a number of efforts to reform the secondary market, which include regulation over stock exchanges, prescription of capital adequacy norms for brokers, regulation over insider trading, regulation over depositories and participants and rules for substantial acquisition of shares and take-overs.

10.15 KEY WORDS

Capital Market : Capital market is that segment of the financial market wherein transactions involving long term funds are undertaken. For example, the securities market, where transactions in long and medium term securities are under-taken is known as the capital market.

Closely held company : Closely held company is that company in which the majority of shares are held by a few share-holders.

Entry Norms for new Issues : Securities and Exchange Board of India has prescribed certain conditions to be satisfied by a company before it issues its securities in the primary market. Such conditions are known as Entry Norms for new issues.

Free Pricing of New Issues : The price at which a new security is to be issued to be determined freely by an issuer of a security is called free pricing of new issues. In other words, the premium to be charged is decided by the issuer company itself.

Insider Trading : Insider trading is dealing, either on his own behalf of a company listed on any stock exchange on the basis of any unpublished price sensitive information (i.e. information, if published, is likely to materially affect the price of the security).

Intermediaries : Intermediaries are those persons who are associated with the securities market and act in between the investors and the issuers of securities. They facilitate the securities transactions, for example, merchant bankers, brokers, underwriters, Registrar to an issue, depository participants, etc.

Listing of Securities : When a particular security is approved by the Stock Exchange for being transacted at that Exchange, it is called as listing of the security. The company whose security is listed is called a listed company.

Merchant Bankers : Merchant Bankers are the intermediaries in the financial markets, who render various non-fund based services to their company clients, e.g. management of new issues, syndication of loans, etc.

Mutual Fund : A mutual fund is a collective investment devise established as trusts. Mutual fund collects the

savings of the investors by issuing units under various schemes and invest them in transferable securities in the capital market.

Primary Market : That segment of the capital market in which new securities are issued by the issuer to the investors for the first time.

Scheduled Bank : A bank whose name has been included in Second Schedule to the Reserve Bank of India Act. The bank must satisfy the conditions prescribed in Section 42 of the Reserve Bank of India Act.

Secondary Market : That segment of the capital market in which existing (i.e. already issued) securities are dealt with.

Securities Depository : Securities depository keeps the record of the securities held by investors in dematerialised form, i.e. transactions in securities are recorded in the books itself and physical securities no more remain in existence.

Stock Exchange : Stock Exchange is an organised market for undertaking secondary market transaction in securities.

Underwriters : Underwriters are those intermediaries who take upon themselves the responsibility to subscribe to that portion of the securities issued by a company which remain un-subscribed by the investing public.

10.16 SOME USEFUL BOOKS

Annual Reports of Securities and Exchange Board of India (1996), RBI.

Avadhani, V.A. (1996): *Investment Management.*

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Economic Survey (Government of India) (Relevant Chapters), 2002.

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Report on Currency and Finance (Reserve Bank of India) (Relevant Chapters), 1996.

Sundharam, K.P.M. and Varshney, P.N. (2000): *Banking and Financial System,* Sultan Chand and Sons, Delhi

Taxman (1998): *Companies Act with SEBI Rules/Regulations and Guidelines.*

Varshney P.N. and Mittal D.K. (2002): *Indian Financial System,* Sultan Chand and Sons, Delhi

10.17 ANSWERS/HINTS TO CHECK YOUR PROGRESS

Check Your Progress 1

1) See Section 10.2

2) Stock broker, sub-broker, share transfer agent, banker to an issue, transfer of trust deed, merchant banker, under-writer, port-folio manager, investment advisor, depository participant, credit rating agencies, foreign institutional investment etc.

3) See Section 10.3 under point 3 and 4.

4) See Section 10.4

Check Your Progress 2

1) (i) three (ii) three

2) (i) True (ii) False (iii) True

Check Your Progress 3

1) Insider trading refers to dealing in securities of a company by a person who is or was connected with the company and having access to unpublished price sensitive information. Such a person is prohibited from dealing in security of a company communicating any unpublished price, and counselling another person who deals in securities on the basis of unpublished price sensitive information.

2) See Section 10.12

3) A revision of the offer or withdrawal of the offer.