SECURITY ANALYSIS AND PORTFOLO MANAGEMNT: UNIT-2

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UNIT - 2

INTRODUCTION OF CAPITAL MARKET

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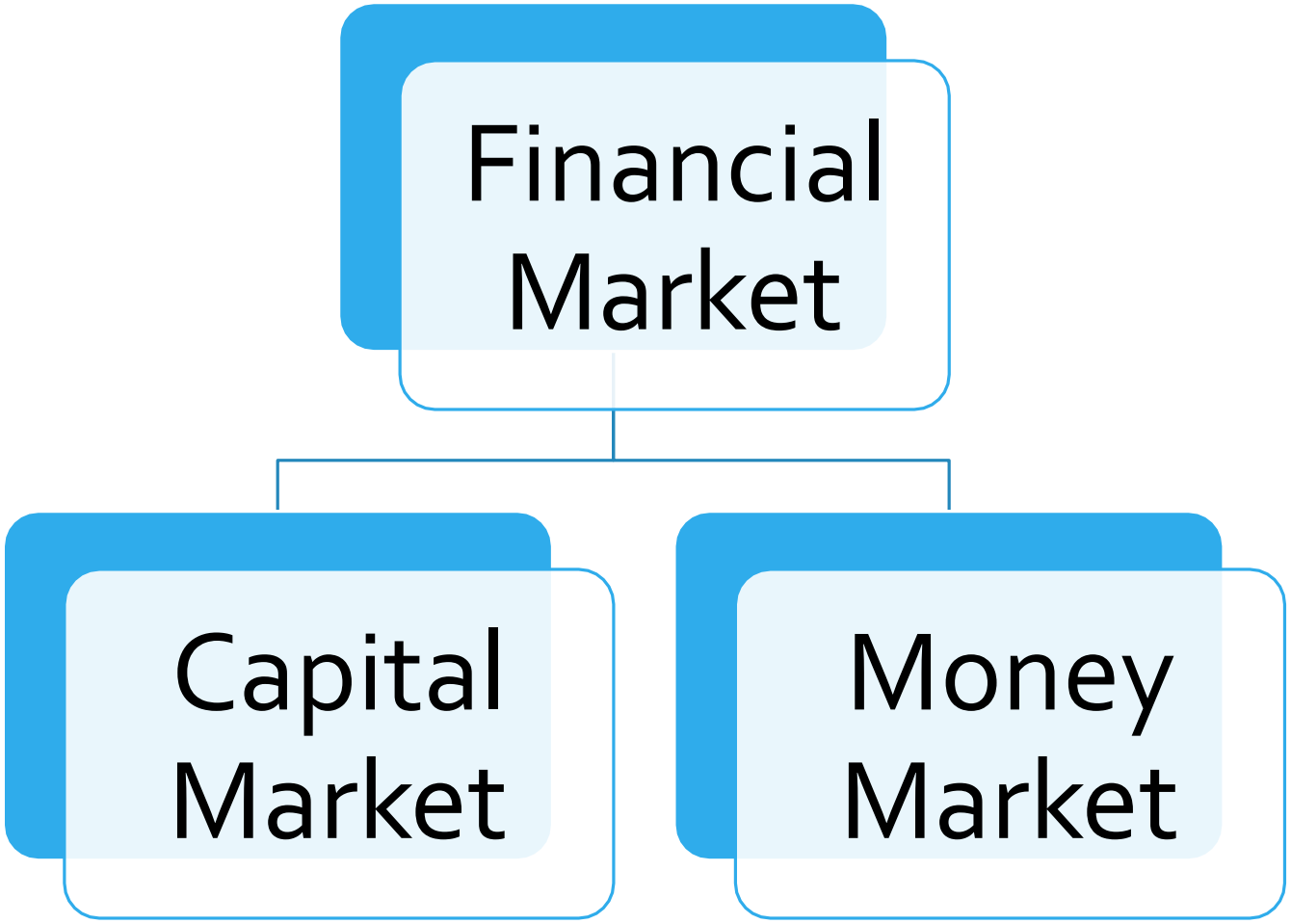
CAPITAL MARKET

INTRODUCTION



CAPITAL MARKET :

Capital market is a market for long-term securities that includes both debt and equity. Companies and governments can raise long term funds (more than a year) through this market. The capital market connects the surplus units with the deficit units. It means that the funds are channelized from those who have excess capital to those who need it.

Funds are raised by issuing capital market instruments like stocks and bonds. These instruments have a higher risk than money market instruments. However, at the same time, these instruments generate higher returns. These markets are strictly regulated in order to avoid any fraudulent practices.

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FUNCTIONS

1. Savings Mobilization
2. Formation of Capital
3. Rapid Economic Growth
4. Benefits to Investors
5. Variety of Services
6. Continuous Availability of Funds

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TYPES OF CAPITAL MARKETS

Primary Market

- Public
- Private
- Rights

Secondary Market

- Over the
- Dealer

FUNCTIONS OF CAPITAL MARKET

Capital market plays an important role in the development of an economy. Let us discuss the functions of these markets for a deeper insight.

SAVINGS MOBILIZATION

Capital market acts as a link between savers and entrepreneurial borrowers. It transfers money from savers (households) to entrepreneurial borrowers (companies who need capital). This way these markets mobilize savings in an economy and divert them into productive investment. Productive usage of funds paves the way for economic growth and prosperity

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FORMATION OF CAPITAL

Capital formation is the process of increasing the stock of real capital. It includes the creation of capital goods like factories, machinery, tools, equipment and so on. These capital goods are utilized for the production of other goods. Savings are mobilized through the capital market to various sectors such as the agricultural sector, industrial sector, etc in an optimal manner. Optimal allocation increases the rate of capital formation in an economy.

RAPID ECONOMIC GROWTH

The allocation of capital is done optimally, for better utilization of scarce resources. Improvement in capital goods increases the efficiency of labor. Superior and technologically advanced capital goods increase overall productivity. This increased productivity enhances economic growth.

BENEFITS TO INVESTORS

In the capital market, investors are provided with an avenue for long-term investments. Most importantly, investors are offered a wide variety of instruments like bonds, mutual funds, insurance policies, equities, etc. This enables investors to diversify and channelize their savings into the most profitable avenues. To protect investors from any unscrupulous activities, these markets are strictly regulated.

VARIETY OF SERVICES

The capital market provides a wide array of services. Services such as underwriting, export finance, consultancy, merchant banking, credit rating etc. are offered to investors.

LIQUIDITY OF FUNDS

In this market, funds are available for long term investments. Because of organized stock and other exchanges, both security sellers and buyers are readily available. This makes the capital market a liquid market as funds are available continuously.

Types of Capital Market

Primary Market

Secondary Market

PRIMARY MARKET

Primary Market also known as NEW ISSUES MARKET (NIM) is a market for raising fresh capital in the form of shares and debentures. Corporate enterprises, which are desirous of raising capital funds through the issue of securities , approach the primary market.Issuers exchange financial securities for long term funds. The primary market allows for the formation of capital in the country and the accelerated industrial and economic development.

It refers to the set-up which helps the industry to raise the funds by issuing different types of securities.

- The primary market issuance is either done through **public issues** or, **private placement.**
- When an issuance of securities is made to new investors for becoming part of shareholders' family, it is called a public issue.
- The public issue can be further classified into:

Public Issue:

- IPO takes place when an unlisted company makes either a fresh issue of securities. This flags off an avenue for listing and trading of the securities issued in the stock exchanges.
- **Follow-on Public Offering (FPO):**

An FPO takes place when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document.

Private Placement

- When an issuer makes an issue of securities to a specific group of persons where the number of members should not be more than 49, it is called a private placement.

- However, it is neither a rights issue nor a public issue.

BASIS FOR COMPARISON	IPO	FPO
Meaning	IPO refers to an offer of securities made to the public for subscription by the company for the first time	FPO refers to an offer of securities for subscription to the public by a publicly-traded enterprise
Issuer	Unlisted company	Listed company
Raising Capital	Through the first time from public	Through a subsequent public contribution
Risk	High	Comparatively low
Objective	The main objective is raising capital through public investment	The main objective is subsequent public investment
Predictability	Less predictable	More predictable
Profit	Higher than FPO	Lower than IPO
Types	Equity shares and Preferred shares	Dilutive offering and Non-Dilutive offering

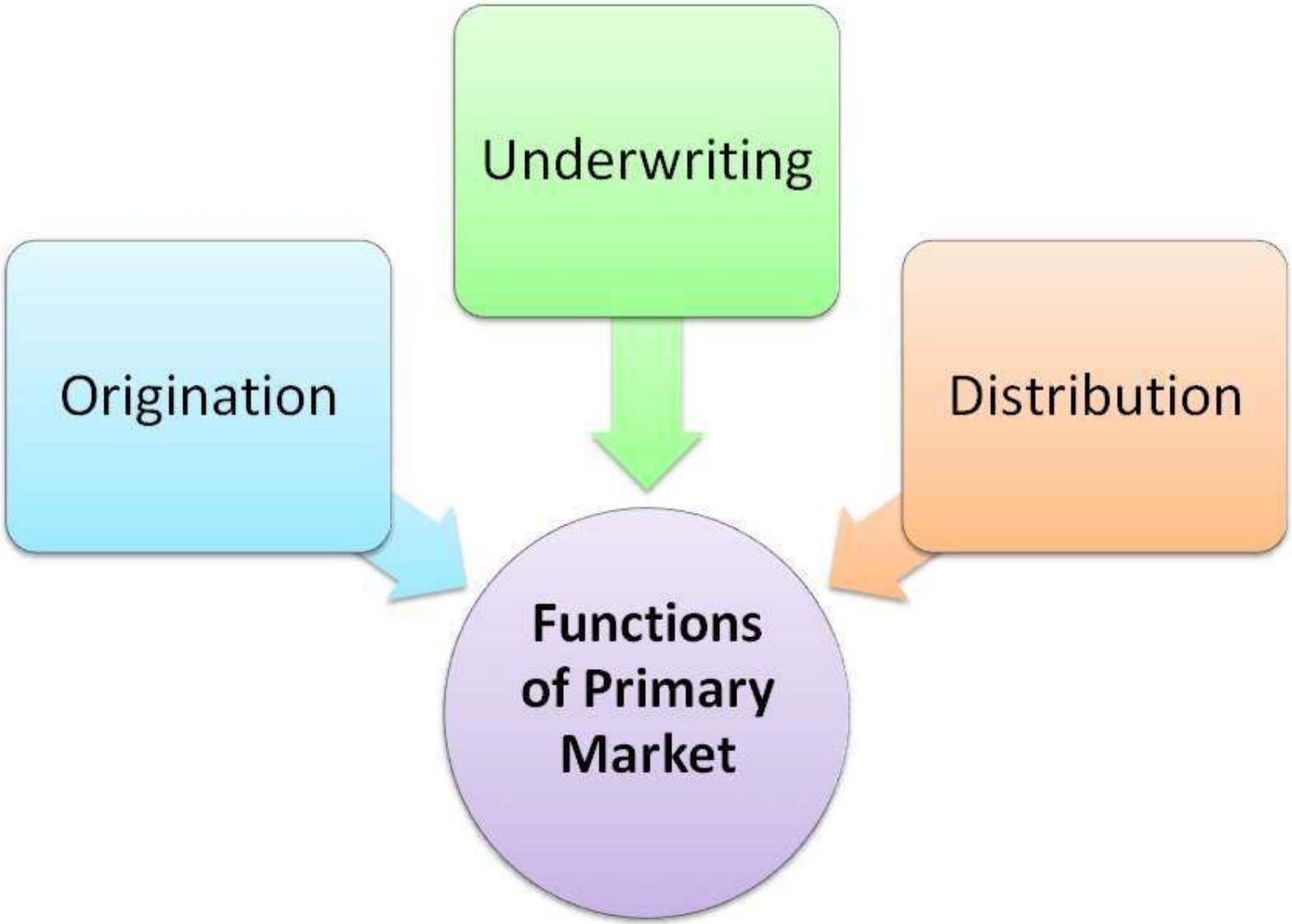
Features of Primary Market

- This is the market for new long term equity capital.
- The primary market is the market where the securities are sold for the first time.
- In a primary issue, the securities are issued by the company directly to investors.
- The company receives the money and issues new security certificates to the investors.

- Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business.
- Borrowers in the new issue market may be raising capital for converting private capital into public capital; this is known as "going public."

The need for primary market

- To raise funds for certain purpose.
- To create market for new issues of securities.
- To establish the magnitude of the market.
- To mobilize Resource the economy.
- For overall development of companies.



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FUNCTIONS

- **Origination-**

In primary market, origination means to investigate, evaluate and procedure new project proposals. It initiates before an issue is present in the market. It is done with the help of merchant bankers.The merchant bankers can be Banks, financial institutions, private investment firms, etc.In primary market, the preliminary investigation involves a detailed study of economic, financial, legal, technical aspects to ensure the soundness of the project. The second function is performed by sponsoring institutions. They provide advisory service.

- Advisory service includes:
- Types of issue,
- Pricing,
- Methods of issue, etc.

- **Underwriting**- In primary market, to ensure success of new issue, there is a need for underwriting firms. The company needs to appoint underwriters. They can be banks or financial institutions or specialized underwriting firms. In primary market, underwriting can be done by a single underwriter or by a group of underwriters. Minimum subscription is guaranteed by underwriters. If the issue is completely subscribed, no liability would be left for the underwriters. If by chance any part of the issue remains unsold, afterwards the underwriter has no option, rather than buying all the unsubscribed shares.

- **Distribution**- In primary market, the success of any grand new issue is hinges on the issue is being subscribed by the people. The sale of the securities to the supreme or highest investors is termed as distribution. Distribution Job is given to brokers and dealers. The brokers or agents maintain direct contact with the supreme investors

The Secondary Market

- A market, which deals in securities that have been already issued by companies , is known as “the secondary market”. It is also called the stock exchange or the share market. The secondary market is that market in which the buying and selling of the previously issued securities is done. The transactions of the secondary market are generally done through the medium of stock exchange.
- The chief purpose of the secondary market is to create liquidity in securities.

What are the products dealt in Secondary Markets ?

- Equity shares.
- Debentures.
- Government securities.
- Bonds.
- Commercial Papers.
- SEBI Risk Management System

What is Debt & Equity?

Debt is an obligation to pay interest. Equity is a share in a company

DEBT CAPITAL

A basic loan is the simplest form of debt

It consists of an agreement to lend a principal sum for a fixed period of time, to be repaid by a certain date.

Debt capital differs from equity or share capital because subscribers to debt capital do not become part owners of the business, but are merely creditors, and the suppliers of debt capital usually receive a contractually fixed annual percentage return on their loan, and this is known as the coupon rate

EQUITY CAPITAL

Equity capital generally is composed of funds that are raised by a business in exchange for an ownership interest in the company. In addition to taking an ownership interest in the company, equity investors may also participate as a member of the company's board of directors and take an active role in managing your company.

Debt Market

Debt Market is associated with low risk in comparison to equity market and also debt market assures regular income and capital preservation. Equity market is more riskier than debt market and is usually volatile. When you invest in equity, you become a shareholder of the company and you may receive profits of the company in the form of dividends. The returns from equity are also comparatively higher than the debt instruments. In equity market, shares are bought and sold. Debt market: Here, bonds, certificates of deposits, debentures, G-Secs are sold.

Bonds: A bond can be issued by a government or a company. The investor in bond simply lends money to the bond issuer and in turn the bond issuer offers to repay the loan on a particular maturity period. The bond issuer also pays interest to the investor on a regular basis till the tenure of the loan.

G-Secs: These are issued by the RBI on behalf of government of India. These pay a fixed coupon and are either for a short term or a long term period.

Debentures: These are issued by companies and bear a fixed rate of interest. Some debentures are

Equity market

Mostly, investors are hesitant to enter the equity market as they are afraid of losses. Equity markets are vulnerable to political, economic, national and global factors.

One can either be an investor or a trader in equity markets. Any company issues shares for the sake of rising capital. When you buy shares of the company, you become a shareholder. As the company is poised to grow, the value of your share also increases in due course of time. It is very essential to know when to hold and when to sell the stock.

Traders buy and sell shares within a short period of time. You can also invest in shares to achieve long term goals. To buy and sell shares, you should hold a demat account.

Difference between primary market and secondary market

Primary Issue V/s Secondary Market

The two types of markets in the Indian capital market

Primary Issue	Secondary Market
A Primary Issue is a fresh issue of securities to the investor at a fixed price (issue price).	A Secondary Market is where the securities can be traded at a premium or discount from the issue price

Primary market	**Secondary market**
In primary markets, securities are bought by way of public issue directly from the company.	In Secondary market share are traded between two investors.
New issue are available in primary market.	Securities usually bought and sold through the secondary market.
The primary is a middlemen.	The secondary market are broker and dealer.
New issue of common stock;bonds and preferred stock are sold by companies.	The secondary market stock and bonds issues are sold to the public.

Trading Procedure on a Stock Exchange:

The Trading procedure involves the following steps:

1. Selection of a broker:

The buying and selling of securities can only be done through SEBI registered brokers who are members of the Stock Exchange. The broker can be an individual, partnership firms or corporate bodies. So the first step is to select a broker who will buy/sell securities on behalf of the investor or speculator.

2. Opening Demat Account with Depository:

Demat (Dematerialized) account refer to an account which an Indian citizen must open with the depository participant (banks or stock brokers) to trade in listed securities in electronic form. Second step in trading procedure is to open a Demat account.

The securities are held in the electronic form by a depository. Depository is an institution or an organization which holds securities (e.g. Shares, Debentures, Bonds, Mutual (Funds, etc.) At present in India there are two depositories: NSDL (National Securities Depository Ltd.) and CDSL (Central Depository Services Ltd.) There is no direct contact between depository and investor. Depository interacts with investors through depository participants only.

Depository participant will maintain securities account balances of investor and intimate investor about the status of their holdings from time to time.

3. Placing the Order:

After opening the Demat Account, the investor can place the order. The order can be placed to the broker either (DP) personally or through phone, email, etc.

Investor must place the order very clearly specifying the range of price at which securities can be bought or sold. e.g. “Buy 100 equity shares of Reliance for not more than Rs 500 per share.”

4. Executing the Order:

As per the Instructions of the investor, the broker executes the order i.e. he buys or sells the securities. Broker prepares a contract note for the order executed. The contract note contains the name and the price of securities, name of parties and brokerage (commission) charged by him. Contract note is signed by the broker.

5. Settlement:

This means actual transfer of securities. This is the last stage in the trading of securities done by the broker on behalf of their clients. There can be two types of settlement.

(a) On the spot settlement:

It means settlement is done immediately and on spot settlement follows. T + 2 rolling settlement. This means any trade taking place on Monday gets settled by Wednesday.

(b) Forward settlement:

It means settlement will take place on some future date. It can be T + 5 or T + 7, etc. All trading in stock exchanges takes place between 9.55 am and 3.30 pm. Monday to Friday.

Securities and Exchange Board of India (SEBI)

- SEBI is an apex (top) body for overall development and regulation of the securities market.
- Government of India constituted SEBI on April 12, 1988 – as an interim body under the administrative control of the Finance Ministry.
- Securities and Exchange Board of India (SEBI) was initially constituted on 12th April, 1988 as a non-statutory body through a resolution of the Government for dealing with all matters relating to the development and regulation of securities market and investor protection and to advices the Government on all these matters.
- SEBI was given statutory status and powers through an ordinance promulgated on January 30, 1992.
- Later on SEBI became a statutory body under the Securities and Exchange Board of India Act, 1992.

- The statutory powers and functions of SEBI were strengthened through the promulgation of the Securities Laws (Amendment) ordinance on January 25, 1995 which was subsequently replaced by an Act of parliament.

- In terms of this Act, SEBI has been vested with regulatory powers over corporates in the issuance of capital, the transfer of securities and other related matters.

- Besides, SEBI has also been empowered to impose monetary penalties on capital market intermediaries and other participants for a range of violation.

- Under the Act, the SEBI shall consist of a chairman and five other members appointed by the Central government (two members representing the Ministries of Finance and Law, one member from the Reserve Bank of India and two other members).

Reasons for the Establishment of SEBI

- During the fall of the 1970s and the rise of the 1980s, the people of India were preferring to work in the Capital Market as the market was trending.
- Without any authority, problems like unofficial private placements, the rigging of prices, unofficial self-styled merchant bankers started violating the rules and regulations of the stock exchange which caused delays in the delivery of shares.
- The Government felt an immediate need to establish a regulatory body to regulate its working and to find solutions for all the problems the market was going through, as the people were losing interest in the market.
- This led to the establishment of the Security and Exchange Board of India.

Purpose and Role of SEBI

- SEBI helps in creating a healthy environment to facilitate an effective mobilization between the market participants and investors. It helps in locating the resources with the help of the securities market.
- SEBI establish rules and regulations, policy framework and infrastructure to meet the needs of the market.
- The financial market majorly comprises of three groups:
- **The Issuer of Securities**
- **Investors**
- **Financial Intermediaries**

Purpose and Role of SEBI

- The Issuer of Securities : Issuers are the group that works in the corporate department to easily raise funds from the various sources of the market. So, SEBI helps the issuers by providing them a healthy and open environment to work efficiently.
- Investors : The investors are the soul of the market as they keep the market alive by providing accurate supplies, correct information, and protection to the people on a daily basis. SEBI helps investors by creating a malpractice free environment to attract and protect the money of the people who invested in the market.
- Financial Intermediaries: The intermediaries are the people who act as middlemen between the issuers and the investors. SEBI helps in creating a competitive professional market which gives a better service to the issuers and the investors. They also provide efficient infrastructure and secured financial transactions.

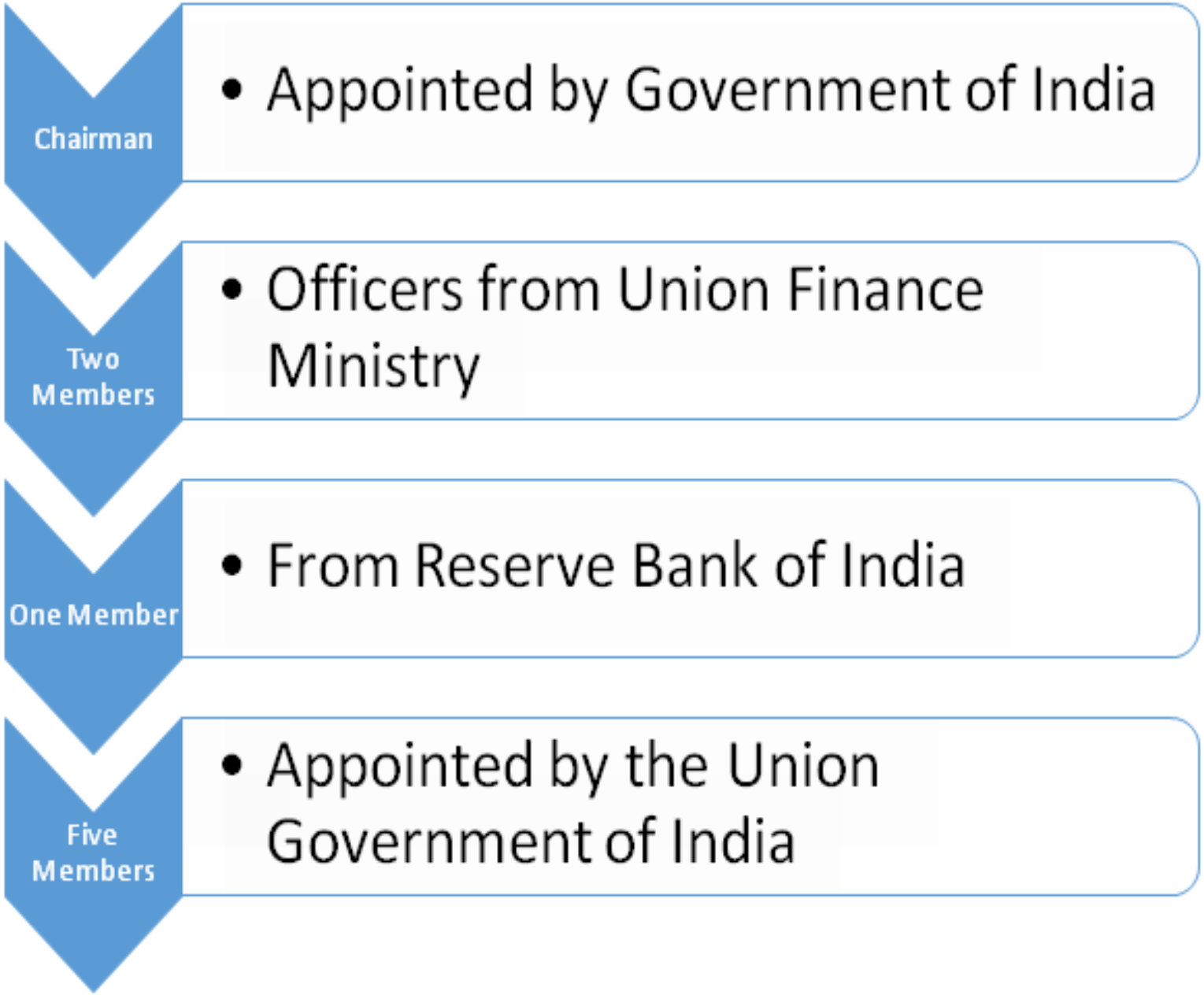
Organizational Structure of SEBI

The members of the Security and Exchange Board of India are:

- The Chairman who is appointed by the Government of India.
- Two members who are selected from the officers of the Union Finance Ministry.
- One member who is appointed from the Reserve Bank of India.
- The other five members are appointed by the Union Government of India, out of five three must be whole-time members.
- Dr. S.A. Dave was the first Chairman of SEBI who was appointed on 10th April 1988. Ajay Tyagi is the present Chairman appointed on 10th February 2017 replacing U K Sinha.

Organizational Structure of SEBI

- SEBI is managed by six members—one chairman (nominated by Central Government), two members, (officers of Central Ministries), one member (from RBI) and remaining two members are nominated by Central Government.
- The office of SEBI is situated at Mumbai with its regional offices at Kolkata, Delhi and Chennai.
- In 1988 the initial capital of SEBI was Rs. 7.5 crore which was provided by its promoters (IDBI, ICICI, and IFCI).
- This amount was invested and with its interest amount, the day-to-day expenses of SEBI are managed.
- All statutory power for regulating Indian Capital Market are vested with SEBI itself.


Chairman
• Appointed by Government of India
Two Members
• Officers from Union Finance Ministry
One Member
• From Reserve Bank of India
Five Members
• Appointed by the Union Government of India

Functions of SEBI

- SEBI basically protects the interest of the investors in the security market, promotes the development of the security market and regulates the business. The functions of the Security and Exchange Board of India can primarily be categorized into three parts:

• Protective Function

- Protective functions are used to protect the **interest of investors** and other financial participants. These functions are:
- **Prevent Insider Trading**: When the people working in the market like director, promoters or employees working in the company starts to buy or sell the securities because they have access to the confidential price which results in affecting the price of the security is known as insider trading. SEBI restricted companies to buy their own shares from the secondary market and SEBI also regulates regular check-ups to prevent insider trading and avoid malpractices.

- **Checks price rigging**: The malpractices which create unreasonable fluctuations in the price of the securities with the help of increasing or decreasing the market price of stocks which results in an immense loss for the investors or traders are known as price rigging.
- To prevent price rigging, SEBI keeps active surveillance on the factors which can promote price rigging.

- **Promotes fair trade practices**: SEBI established rules and regulations and a certain code of conduct in the securities market to restrict fraudulent and unfair trade practices.

- **Providing awareness/financial education for investors**: SEBI conducts seminars both online and offline to educate the investors about insights into the financial market and money management.

Regulatory Function

- Regulatory functions are generally used to check the functioning of the financial business in the market.
- They establish rules to regulate the financial intermediaries and corporates for the efficiency of the market. These functions are:
- SEBI designed guidelines and code of conduct for efficient working of financial intermediaries and corporate.
- Established rules for taking over a company.
- Conducts regular inquiries and audits of stock exchanges.
- Regulates the process of mutual funds.
- Registration of brokers, sub-brokers, and merchant bankers is controlled by SEBI.
- Levying of fees is regulated by SEBI.
- Restrictions on private placement.

Development Function

The development functions are the steps taken by SEBI to improve the security of the market through technology. The functions are:

- By providing training sessions to the intermediaries of the market.
- By promoting fair trading and restrictions on malpractices of any kind.
- By introducing the DEMAT format.
- By promoting self-regulating organizations.
- By introducing online trading through registered stock brokers.
- By providing discount brokerage.

- **Some Other important functions of SEBI are given below:**
- (i) Registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustee of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manners.
- (ii) Registering and regulating the working of the depositories, participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as the Board may, by notification, specify in this behalf.
- (iii) Registering and regulating the working of venture capital funds and collective investment schemes including mutual funds.
- (iv) Helping the business in stock exchanges and any other securities market.

- (v) Promoting and regulating self-regulatory organisations.
- (vi) Prohibiting fraudulent and unfair trade practices relating to securities market.
- (vii) Promoting investors education and training of intermediaries of securities markets.
- (viii) Prohibiting insider trading in securities.
- (ix) Regulating substantial acquisition of shares and takeover of companies.
- (x) Supervise the working of various organisations trading in security market and also to ensure systematic dealings.
- (xi) Conducting research and investigations for ensuring the attainment of above objectives.

Objectives of SEBI

- The main objectives of SEBI are:
- **(1) Regulation of Stock Exchanges:**
- The first objective of SEBI is to regulate stock exchanges so that efficient services may be provided to all the parties operating there.
- **(2) Protection to the Investors:**
- The capital market is meaningless in the absence of the investors. Therefore, it is important to protect the interests of the investors.
- The protection of the interests of the investors means protecting them from the wrong information given by the companies in their prospectus, reducing the risk of delivery and payment, etc. Hence, the foremost objective of the SEBI is to provide security to the investors.
- **(3) Checking the Insider Trading:**
- Insider trading means the buying and selling of securities by those people's directors Promoters, etc. who have some secret information about the company and who wish to take advantage of this secret information.
- This hurts the interests of the general investors. It was very essential to check this tendency. Many steps have been taken to check inside trading through the medium of the SEBI.
- **(4) Control over Brokers:**
- It is important to keep an eye on the activities of the brokers and other middlemen in order to control the capital market. To have a control over them, it was necessary to establish the SEBI

Objectives of SEBI

- Prevention of malpractices: The main objective for the formation of SEBI was to prevent fraud and malpractices related to trading and to regulate the activities of the stock exchange.
- Promoting fair and proper functioning: SEBI was established to maintain the functioning of the capital market and to promote functioning of the stock exchange. They are ordered to keep eyes on the activities of the financial intermediaries and regulate the securities industry efficiently.
- Establishing Balance: SEBI has to maintain a balance between the statutory regulation and self-regulation of the securities industry.
- Establishing a code of conduct: SEBI is required to develop and regulate a code of conduct to avoid frauds and malpractices caused by intermediaries such as brokers, underwriters and other people.

Investor Protection Measures by SEBI.

- Investors are the pillar of the financial and securities market. They determine the level of activity in the market.
- They put the money in funds, stocks, etc. to help grow the market and thus, the economy.
- It thus very important to protect the interests of the investors. investor protection involves various measures established to protect the interests of investors from malpractices.
- Securities and Exchange Board of India (SEBI) is responsible for regulations of the Mutual Funds and safeguard the interests of the investors.
- Investor protection measures by SEBI are in place to safeguard the investors from the malpractices in shares, the stock market, Mutual Fund, etc..
- SEBI has given out various methods and measures to ensure the investor protection from time to time. It has published various directives, driven many investor awareness programmes, set up investor protection Fund (IPF) to compensate the investors..

Investor Protection Measures by SEBI.

- Investor Protection Measures by SEBI Investor protection legislation is implemented under the Section 11(2) of the SEBI Act.
- The measures are as follows:
- Stock Exchange and other securities market business regulation.
- Registering and regulating the intermediaries of the business like brokers, transfer agents, bankers, trustees, registrars, portfolio managers, investment consultants, merchant bankers, etc.
- Recording and monitoring the work of custodians, depositors, participants, foreign investors, credit rating agencies, etc.
- Registering investment schemes like Mutual fund & venture capital funds, and regulating their functioning.
- Promotion and controlling of self-regulatory companies.
- Keeping a check on frauds and unfair trading methods related to the securities market.
- Observing and regulating major transactions and take-over of the companies.
- Carry out investor awareness and education programme.
- Train the intermediaries of the business.
- Inspecting and auditing the security exchanges (SEs) and intermediaries.
- Assessment of fees and other charges..

- **Investor Education and Protection Fund(IEPF): Investor protection measures by SEBI also includes the Government of India established a fund called, Investor Education and Protection Fund(IEPF) under the 1956 Company Act.**
- **According to the act, the company which has completed seven years in the business should hand over all the unclaimed fund dividends, matured deposits, and debentures, share application money etc. to the Government through IEPF.**
- Investor Protection Fund (IPF) is set up by Inter-connected Stock Exchange (ISE) in accordance with the guidelines issued by the Ministry of Finance for investor protection, in order to compensate the claims of investors against the members of exchanges (brokers) who have defaulted or failed to pay.
- The investor can ask for the compensation if a member (broker) of the National Stock Exchange (NSE) or Bombay Stock Exchange (BSE) or any other stock exchange fails to pay the due money for the investments made.
- The Stock Exchanges have put certain limits on the level of compensation paid to the investors.
- This limitation has been put according to the discussions and guidance with the IPF Trust.
- The limit allows that the money to paid as a compensation for a single claim shall not be less than INR 1 lakh - for the case major Stock Exchanges like BSE and NSE - and it should not be less INR 50,000 in case of other Stock Exchanges.

DEFICIENCIES IN THE INDIAN CAPITAL MARKET

The Indian capital market suffers from the following deficiencies:

•Lack of diversity in the financial instruments.

•Lack of control over the fair disclosure of financial information.

•Poor growth in the secondary market.

•Prevalence of insider trading and front running.[1]

•Manipulation of security prices.

•Existence of unofficial trade in the primary market, prior to the issue coming into the market.

•Absence of proper control over brokers and sub-brokers.

•Passive role of public financial institutions in checking malpractices.

•High cost of transactions and intermediation, mainly due to the absence of well-defined norms for institutional investment.

THANK YOU!