INDIAN FINANCIAL MARKET

You are fully aware that business units have to raise short-term as well as long-term funds to meet their working and fixed capital requirements from time to time. This necessitates not only the ready availability of such funds but also a transmission mechanism with the help of which the providers of funds (investors/ lenders) can interact with the borrowers/ users (business units) and transfer the funds to them as and when required. This aspect is taken care of by the financial markets which provide a place where or a system through which, the transfer of funds by investors/lenders to the business units is adequately facilitated.

OBJECTIVES

After studying this lesson, you will be able to:

- explain the concept and functions of financial markets;
- state the nature and importance of money market;
- state the nature and types of capital market;
- distinguish between capital market and money market;
- explain the nature and functions of a stock exchange;
- state the advantages of stock exchanges from the points of view of companies, investors and society as a whole;
- state the limitations of stock exchanges;
- explain the concept of speculation and distinguish it from investment;
- outline the stock exchanges in India; and
- describe the nature of regulation of stock exchanges in India and the role of SEBI.

Contain

FINANCIAL MARKET

We know that, money always flows from surplus sector to deficit sector. That means persons having excess of money lend it to those who need money to fulfill their requirement. Similarly, in business sectors the surplus money flows from the investors or lenders to the businessmen for the purpose of production or sale of goods and services. So, we find two different groups, one who invest money or lend money and the others, who borrow or use the money.

Now you think, how these two groups meet and transact with each other. The financial markets act as a link between these two different groups. It facilitates this function by acting as an intermediary between the borrowers and lenders of money. So, financial market may be defined as 'a transmission mechanism between investors (or lenders) and the borrowers (or users) through which transfer of funds is facilitated'. It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network for trading the various financial assets and credit instruments.
Before reading further let us have an idea about some of the credit instruments.

A **bill of exchange** is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or to the order of a certain person, or to the bearer of the instrument. To clarify the meaning let us take an example. Suppose Gopal has given a loan of Rs. 50,000 to Madan, which Madan has to return. Now, Gopal also has to give some money to Madhu. In this case, Gopal can make a document directing Madan to make payment up to Rs. 50,000 to Madhu on demand or after expiry of a specified period. This document is called a bill of exchange, which can be transferred to some other person's name by Madhu.

A **promissory note** is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to or to the order of a certain person or to the bearer of the instrument. Suppose you take a loan of Rs. 20,000 from your friend Jagan. You can make a document stating that you will pay the money to Jagan or the bearer on demand. Or you can mention in the document that you will pay the amount after three months. This document, once signed by you, duly stamped and handed over to Jagan, becomes a negotiable instrument. Now Jagan can personally present it before you for payment or give this document to some other person to collect money on his behalf. He can endorse it in somebody else's name who in turn can endorse it further till the final payment is made by you to whosoever presents it before you. This type of a document is called a Promissory Note.
Let us now see the main functions of financial market.

(a) It provides facilities for interaction between the investors and the borrowers.
(b) It provides pricing information resulting from the interaction between buyers and sellers in the market when they trade the financial assets.
(c) It provides security to dealings in financial assets.
(d) It ensures liquidity by providing a mechanism for an investor to sell the financial assets.
(e) It ensures low cost of transactions and information.

A financial market consists of two major segments:
(a) Money Market; and (b) Capital Market.

While the money market deals in short-term credit, the capital market handles the medium term and long-term credit.
Let us discuss these two types of markets in detail.

MONEY MARKET

The money market is a market for short-term funds, which deals in financial assets whose period of maturity is upto one year. It should be noted that money market does not deal in cash or money as such but simply provides a market for credit instruments such as bills of exchange, promissory notes, commercial paper, treasury bills, etc. These financial instruments are close substitute of money. These instruments help the business units, other organisations and the Government to borrow the funds to meet their short-term requirement.

Money market does not imply to any specific market place. Rather it refers to the whole networks of financial institutions dealing in short-term funds, which provides an outlet to lenders and a source of supply for such funds to borrowers. Most of the money market transactions are taken place on telephone, fax or Internet. The Indian money market consists of Reserve Bank of India, Commercial banks, Co-operative banks, and other specialised financial institutions. The Reserve Bank of India is the leader of the money market in India. Some Non-Banking Financial Companies (NBFCs) and financial institutions like LIC, GIC, UTI, etc. also operate in the Indian money market.

1.3.1 Money Market Instruments

Following are some of the important money market instruments or securities.

(a) Call Money: Call money is mainly used by the banks to meet their temporary requirement of cash. They borrow and lend money from each other normally on a daily basis. It is repayable on demand and its maturity period varies in between one day to a fortnight. The rate of interest paid on call money loan is known as call rate.

(b) Treasury Bill: A treasury bill is a promissory note issued by the RBI to meet the short-term requirement of funds. Treasury bills are highly liquid instruments, that means, at any time the holder of treasury bills can transfer of or get it discounted from RBI. These bills are normally issued at a price less than their face value; and redeemed at face value. So the difference between the issue price and the face value of the treasury bill represents the interest on the investment. These bills are secured instruments and are issued for a period of not exceeding 364 days. Banks, Financial institutions and corporations normally play major role in the Treasury bill market.

(c) Commercial Paper: Commercial paper (CP) is a popular instrument for financing working capital requirements of companies. The CP is an unsecured instrument issued in the form of promissory note. This instrument was introduced in 1990 to enable the corporate borrowers to raise short-term funds. It can be issued for period ranging from 15 days to one year. Commercial papers are transferable by endorsement and delivery. The highly reputed companies (Blue Chip companies) are the major player of commercial paper market.

(d) Certificate of Deposit: Certificate of Deposit (CDs) are short-term instruments issued by Commercial Banks and Special Financial Institutions (SFIs), which are freely transferable from one party to another. The maturity period of CDs ranges from 91 days to one year. These can be issued to individuals, co-operatives and companies.

(e) Trade Bill: Normally the traders buy goods from the wholesalers or manufactures on credit. The sellers get payment after the end of the credit period. But if any seller does not want to wait or in immediate need of money he/she can draw a bill of exchange in favour of the buyer. When buyer accepts the bill it becomes a negotiable instrument and is termed as bill of exchange or trade bill. This trade bill can now be discounted with a bank before its maturity. On maturity the bank gets the payment from the drawee i.e., the buyer of goods. When trade bills are accepted by Commercial Banks it is known as Commercial Bills. So trade bill is an instrument, which enables the drawer of the bill to get funds for short period to meet the working capital needs.

4 Capital Market

Capital Market may be defined as a market dealing in medium and long-term funds. It is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc. In the present chapter let us discuss about the market for trading of securities.

The market where securities are traded known as Securities market. It consists of two different segments namely primary and secondary market. The primary market deals with new or fresh issue of securities and is, therefore, also known as **new issue market**; whereas the secondary market provides a place for purchase and sale of existing securities and is often termed as **stock market** or **stock exchange**.

1.4.1 Primary Market

The Primary Market consists of arrangements, which facilitate the procurement of long-term funds by companies by making fresh issue of shares and debentures. You know that companies make fresh issue of shares and/or debentures at their formation stage and, if necessary, subsequently for the expansion of business. It is usually done through private placement to friends, relatives and financial institutions or by making public issue. In any case, the companies have to follow a well-established legal procedure and involve a number of intermediaries such as underwriters, brokers, etc. who form an integral part of the primary market. You must have learnt about many initial public offers (IPOs) made recently by a number of public sector undertakings such as ONGC, GAIL, NTPC and the private sector companies like Tata Consultancy Services (TCS), Biocon, Jet-Airways and so on.

1.4.2 Secondary Market

The secondary market known as stock market or stock exchange plays an equally important role in mobilising long-term funds by providing the necessary liquidity to holdings in shares and debentures. It provides a place where these securities can be encashed without any difficulty and delay. It is an organised market where shares, and debentures are traded regularly with high degree of transparency and security. In fact, an active secondary market facilitates the growth of primary market as the investors in the primary market are assured of a continuous market for liquidity of their holdings. The major players in the primary market are merchant bankers, mutual funds, financial institutions, and the individual investors; and in the secondary market you have all these and the stockbrokers who are members of the stock exchange who facilitate the trading.

After having a brief idea about the primary market and secondary market let see the difference between them.

Distinction between Primary Market and Secondary Market

The main points of distinction between the primary market and secondary market are as follows:

1. **Function :** While the main function of primary market is to raise long-term funds through fresh issue of securities, the main function of secondary market is to provide continuous and ready market for the existing long-term securities.
2. **Participants:** While the major players in the primary market are financial institutions, mutual funds, underwriters and individual investors, the major players in secondary market are all of these and the stockbrokers who are members of the stock exchange.
3. **Listing Requirement:** While only those securities can be dealt within the secondary market, which have been approved for the purpose (listed), there is no such requirement in case of primary market.
4. **Determination of prices:** In case of primary market, the prices are determined by the management with due compliance with SEBI requirement for new issue of securities. But in case of secondary market, the price of the securities is determined by forces of demand and supply of the market and keeps on fluctuating.

1.6 Distinction between Capital Market and Money Market

Capital Market differs from money market in many ways. Firstly, while money market is related to short-term funds, the capital market related to long term funds. Secondly, while money market deals in securities like treasury bills, commercial paper, trade bills, deposit certificates, etc., the capital market deals in shares, debentures, bonds and government securities. Thirdly, while the participants in money market are Reserve Bank of India, commercial banks, non-banking financial companies, etc., the participants in capital market are stockbrokers, underwriters, mutual funds, financial institutions, and individual investors. Fourthly, while the money market is regulated by Reserve Bank of India, the capital market is regulated by Securities Exchange Board of India (SEBI).

(a) Distinction between Primary Market and Secondary Market.

Points of Difference	Primary Market	Secondary Market
1. Function	(i)	To provide continuous and ready market for existing long-term securities.
2. Participants	Financial Institutions, mutual funds, underwriters and individual investors.	(ii)
3. Listing Requirement	Listing is not required for dealing in the primary market.	(iii)

4. Determination of Prices	(iv)	Prices are determined by forces of demand ar supply and keep on fluctuating.

(b) Differentiate between Money Market and Capital Market.

Point of Distinction	Money Market	Capital Market
1. Time period / Term 2. Instrument dealt in 3. Participants 4. Regulatory body		

1.7 Stock Exchange

As indicated above, stock exchange is the term commonly used for a secondary market, which provide a place where different types of existing securities such as shares, debentures and bonds, government securities can be bought and sold on a regular basis. A stock exchange is generally organised as an association, a society or a company with a limited number of members. It is open only to these members who act as brokers for the buyers and sellers. The Securities Contract (Regulation) Act has defined stock exchange as an " association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling business of buying, selling and dealing in securities".

The main characteristics of a stock exchange are:

1. It is an organised market.
2. It provides a place where existing and approved securities can be bought and sold easily.
3. In a stock exchange, transactions take place between its members or their authorised agents.
4. All transactions are regulated by rules and by laws of the concerned stock exchange.
5. It makes complete information available to public in regard to prices and volume of transactions taking place every day.

It may be noted that all securities are not permitted to be traded on a recognised stock exchange. It is allowed only in those securities (called listed securities) that have been duly approved for the purpose by the stock exchange authorities. The method of trading now-a-days, however, is quite simple on account of the availability of on-line trading facility with the help of computers. It is also quite fast as it takes just a few minutes to strike a deal through the brokers who may be available close by. Similarly, on account of the system of scrip-less trading and rolling settlement, the delivery of securities and the payment of amount involved also take very little time, say, 2 days.

1.7.1 Functions of a Stock Exchange

The functions of stock exchange can be enumerated as follows:

1. **Provides ready and continuous market:** By providing a place where listed securities can be bought and sold regularly and conveniently, a stock exchange ensures a ready and continuous market for various shares, debentures, bonds and government securities. This lends a high degree of liquidity to holdings in these securities as the investor can encash their holdings as and when they want.
2. **Provides information about prices and sales:** A stock exchange maintains complete record of all transactions taking place in different securities every day and supplies regular information on their prices and sales volumes to press and other media. In fact, now-a-days, you can get information about minute to minute movement in prices of selected shares on TV channels like CNBC, Zee News, NDTV and Headlines Today. This enables the investors in taking quick decisions on purchase and sale of securities in which they are interested. Not only that, such information helps them in ascertaining the trend in prices and the worth of their holdings. This enables them to seek bank loans, if required.
3. **Provides safety to dealings and investment:** Transactions on the stock exchange are conducted only amongst its members with adequate transparency and in strict conformity to its rules and regulations which include the procedure and timings of delivery and payment to be followed. This provides a high degree of safety to dealings at the stock exchange. There is little risk of loss on account of non-payment or non-delivery. Securities and Exchange Board of India (SEBI) also regulates the business in stock exchanges in India and the working of the stock brokers.

Not only that, a stock exchange allows trading only in securities that have been listed with it; and for listing any security, it satisfies itself about the genuineness and soundness of the company and provides for disclosure of certain information on regular basis. Though this may not guarantee the soundness and profitability of the company, it does provide some assurance on their genuineness and enables them to keep track of their progress.

4. Helps in mobilisation of savings and capital formation: Efficient functioning of stock market creates a conducive climate for an active and growing primary market. Good performance and outlook for shares in the stock exchanges imparts buoyancy to the new issue market, which helps in mobilising savings for investment in industrial and commercial establishments. Not only that, the stock exchanges provide liquidity and profitability to dealings and investments in shares and debentures. It also educates people on where and how to invest their savings to get a fair return. This encourages the habit of saving, investment and risk-taking among the common people. Thus it helps mobilising surplus savings for investment in corporate and government securities and contributes to capital formation.

5. Barometer of economic and business conditions: Stock exchanges reflect the changing conditions of economic health of a country, as the shares prices are highly sensitive to changing economic, social and political conditions. It is observed that during the periods of economic prosperity, the share prices tend to rise. Conversely, prices tend to fall when there is economic stagnation and the business activities slow down as a result of depressions. Thus, the intensity of trading at stock exchanges and the corresponding rise on fall in the prices of securities reflects the investors' assessment of the economic and business conditions in a country, and acts as the barometer which indicates the general conditions of the atmosphere of business.

6. Better Allocation of funds: As a result of stock market transactions, funds flow from the less profitable to more profitable enterprises and they avail of the greater potential for growth. Financial resources of the economy are thus better allocated.

1.7.2 Advantages of Stock Exchanges

Having discussed the functions of stock exchanges, let us look at the advantages which can be outlined from the point of view of (a) Companies, (b) Investors, and (c) the Society as a whole.

(a)**To the Companies**

(i) The companies whose securities have been listed on a stock exchange enjoy a better goodwill and credit-standing than other companies because they are supposed to be financially sound.

(ii) The market for their securities is enlarged as the investors all over the world become aware of such securities and have an opportunity to invest

(iii) As a result of enhanced goodwill and higher demand, the value of their securities increases and their bargaining power in collective ventures, mergers, etc. is enhanced.

(iv) The companies have the convenience to decide upon the size, price and timing of the issue.

(b) To the Investors:

(i) The investors enjoy the ready availability of facility and convenience of buying and selling the securities at will and at an opportune time.

(ii) Because of the assured safety in dealings at the stock exchange the investors are free from any anxiety about the delivery and payment problems.

(iii) Availability of regular information on prices of securities traded at the stock exchanges helps them in deciding on the timing of their purchase and sale.

(iv) It becomes easier for them to raise loans from banks against their holdings in securities traded at the stock exchange because banks prefer them as collateral on account of their liquidity and convenient valuation.

(c) To the Society

(i) The availability of lucrative avenues of investment and the liquidity thereof induces people to save and invest in long-term securities. This leads to increased capital formation in the country.

(ii) The facility for convenient purchase and sale of securities at the stock exchange provides support to new issue market. This helps in promotion and expansion of industrial activity, which in turn contributes, to increase in the rate of industrial growth.

(iii) The Stock exchanges facilitate realisation of financial resources to more profitable and growing industrial units where investors can easily increase their investment substantially.

(iv) The volume of activity at the stock exchanges and the movement of share prices reflect the changing economic health

(v) Since government securities are also traded at the stock exchanges, the government borrowing is highly facilitated. The bonds issued by governments, electricity boards, municipal corporations and public sector undertakings (PSUs) are found to be on offer quite frequently and are generally successful.

1.7.3 Limitations of Stock Exchanges

Like any other institutions, the stock exchanges too have their limitations. One of the common evils associated with stock exchange operations is the excessive speculation. You know that speculation implies buying or selling securities to take advantage of price differential at different times. The speculators generally do not take or give delivery and pay or receive full payment. They settle their transactions just by paying the difference in prices. Normally, speculation is considered a healthy practice and is necessary for successful operation of stock exchange activity. But, when it becomes excessive, it leads to wide fluctuations in prices and various malpractices by the vested interests. In the process, genuine investors suffer and are driven out of the market.

Another shortcoming of stock exchange operations is that security prices may fluctuate due to unpredictable political, social and economic factors as well as on account of rumours spread by interested parties. This makes it difficult to assess the movement of prices in future and build appropriate strategies for investment in securities. However, these days good amount of vigilance is exercised by stock exchange authorities and SEBI to control activities at the stock exchange and ensure their healthy functioning, about which you will study later.

The buyers and sellers at the stock exchange undertake two types of operations, one for speculation and the other for investment. Those who buy securities primarily to earn a regular income from such investment and possibly make some long-term gain on account of price rise in future are called investors. They take delivery of the securities and make full payment of the price. Such transactions are called investment transactions.

But, when the securities are bought with the sole object of selling them in future at higher prices or these are sold now with the intention of buying at a lower price in future, are called speculation transactions. The main objective of such transactions is to take advantage of price differential at different times. The stock exchange also provides for settlement of such transactions even by receiving or paying, as the case may be, just the difference in prices. For example, Rashmi bought 200 shares of Moser Baer Ltd. at Rs. 210 per share and sold them at Rs. 235 per share. He does not take and give delivery of the shares but settles the transactions by receiving the difference in prices amounting to Rs. 5,000 minus brokerage. In another case, Mohit bought 200 shares of Seshasayee Papers Ltd. at Rs. 87 per share and sold them at Rs. 69 per share. He settles these transactions by simply paying the difference amounting to Rs. 3600 plus brokerage. However, now-a-days stock exchanges have a system of rolling settlement. Such facility is limited only to transactions of purchase and sale made on the same day, as no carry forward is allowed.

Rolling Settlement: Earlier trading in the stock exchange was held face-to-face (called pit-trading) without the use of computers and the advanced computer software as it is today. In those times, transactions were settled (i.e., actual delivery of shares, through share certificates, by the seller and payment of money by the buyer) in the stock exchange, only on a fixed day of the week, say on a Saturday, or a Wednesday irrespective of which day of the week the shares were bought and sold. This was called 'Fixed Settlement'.

Today, with the electronic / computer based system of recording and carrying out of share transactions, stock exchanges go in for 'rolling settlement'. That means, transaction are settled after a fixed number of days of the transaction rather than on a particular day of the week. For example, if a stock exchange goes in for 'T+2' days of rolling settlement, the transaction is settled within two working days of occurring of the transaction, 'T' being the day of the transaction. In T+7' days of rolling settlement, the transaction is settled on the 7^{th} day after the transaction. This is facilitated through electronic transfer of shares, through Dematerialised Account or Demat Account i.e., the share does not have a physical form of a paper document, but is a computerised record of a person holding a share, and through transfer of money electronically or through cheques payment is settled.

Though speculation and investment are different in some respects, in practice it is difficult to say who is a genuine investor and who is a pure speculator. Sometimes even a person who has purchased the shares as a long-term investment may suddenly decide to sell to reap the benefit if the price of the share goes up too high or do it to avoid heavy loss if the prices starts declining steeply. But he cannot be called a speculator because his basic intention has been to invest. It is only when a person's basic intention is to take advantage of a change in prices, and not to invest, then the transaction may be termed as speculation. In strict technical terms, however, the transaction is regarded as speculative only if it is settled by receiving or paying the difference in prices without involving the delivery of securities. It is so because, in practice, it is quite difficult to ascertain the intention.

Some people regard speculation as nothing but gambling and consider it as an evil. But it is not true because while speculation is based on foresight and hard calculation, gambling is a kind of blind and reckless activity involving high degree of chance element. No only that, speculation is a legal activity duly recognised as a prerequisite for the success of stock exchange operations while gambling is regarded as an evil and a punishable activity. However, reckless speculation may take the form of gambling and should be avoided.

QUESTIONS 18B

1. Enumerate the main characteristics of a stock exchange.
2. Identify if the following statement about stock exchanges are 'True' or 'False'. If the statement is 'False', rewrite it in the correct form.

(a) Stock Exchange provides a ready market for sale and purchase of gold and silver.
(b) In the stock exchange, transactions take place between companies and their shareholders directly.
(c) Stock exchange transactions facilitate flow of funds from less profitable to more profitable enterprises.
d) It becomes difficult for investors to raise loans from banks against collateral of their holdings in securities traded at the stock exchange.
(e) Speculation is the same thing as gambling.

3. State two limitations of stock exchanges.

1.9 STOCK EXCHANGES IN INDIA

The first organised stock exchange in India was started in Mumbai known as Bombay Stock Exchange (BSE). It was followed by Ahmedabad Stock Exchange in 1894 and Kolkata Stock Exchange in 1908. The number of stock exchanges in India went upto 7 by 1939 and it increased to 21 by 1945 on account of heavy speculation activity during Second World War. A number of unorganised stock exchanges also functioned in the country without any formal set-up and were known as kerb market. The Security Contracts (Regulation) Act was passed in 1956 for recognition and regulation of Stock Exchanges in India. At present we have 23 stock exchanges in the country. Of these, the most prominent stock exchange that came up is National Stock Exchange (NSE). It is also based in Mumbai and was promoted by the leading financial institutions in India. It was incorporated in 1992 and commenced operations in 1994. This stock exchange has a corporate structure, fully automated screen-based trading and nation-wide coverage.

Another stock exchange that needs special mention is Over The Counter Exchange of India (OTCEI). It was also promoted by the financial institutions like UTI, ICICI, IDBI, IFCI, LIC etc. in September 1992 specially to cater to small and medium sized companies with equity capital of more than Rs.30 lakh and less than Rs.25 crore. It helps entrepreneurs in raising finances for their new projects in a cost effective manner. It provides for nation-wide online ringless trading with 20 plus representative offices in all major cities of the country. On this stock exchange, securities of those companies can be traded which are exclusively listed on OTCEI only. In addition, certain shares and debentures listed with other stock exchanges in India and the units of UTI and other mutual funds are also allowed to be traded on OTCEI as permitted securities. It has been noticed that, of late, the turnover at this stock exchange has considerably reduced and steps have been afoot to revitalise it. In fact, as of now, BSE and NSE are the two Stock Exchanges, which enjoy nation-wide coverage and handle most of the business in securities in the country.

.10 REGULATIONS OF STOCK EXCHANGES

As indicated earlier, the stock exchanges suffer from certain limitations and require strict control over their activities in order to ensure safety in dealings thereon. Hence, as early as 1956, the Securities Contracts (Regulation) Act was passed which provided for recognition of stock exchanges by the central Government. It has also the provision of framing of proper bylaws by every stock exchange for regulation and control of their functioning subject to the approval by the Government. All stock exchanges are required submit information relating to its affairs as required by the Government from time to time. The Government was given wide powers relating to listing of securities, make or amend bylaws, withdraw recognition to, or supersede the governing bodies of stock exchange in extraordinary/abnormal situations. Under the Act, the Government promulgated the Securities Regulations (Rules) 1957, which provided *inter alia* for the procedures to be followed for recognition of the stock exchanges, submission of periodical returns and annual returns by recognised stock exchanges, inquiry into the affairs of recognised stock exchanges and their members, and requirements for listing of securities.

ROLE OF SEBI

As part of economic reforms programme started in June 1991, the Government of India initiated several capital market reforms, which included the abolition of the office of the Controller of Capital Issues (CCI) and granting statutory recognition to Securities Exchange Board of India (SEBI) in 1992 for:
(a) protecting the interest of investors in securities; (b) promoting the development of securities market; (c) regulating the securities market; and (d) matters connected there with or incidental thereto.
SEBI has been vested with necessary powers concerning various aspects of capital market such as:

(i) regulating the business in stock exchanges and any other securities market;
(ii) registering and regulating the working of various intermediaries and mutual funds;
(iii) romoting and regulating self regulatory organisations;
(iv)promoting investors education and training of intermediaries; (v) prohibiting insider trading and unfair trade practices;
(vi) regulating substantial acquisition of shares and take over of companies;

(vii) calling for information, undertaking inspection, conducting inquiries and audit of stock exchanges, and intermediaries and self regulation organisations in the stock market; and
(viii) performing such functions and exercising such powers under the provisions of the Capital Issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government.

As part of its efforts to protect investors' interests, SEBI has initiated many primary market reforms, which include improved disclosure standards in public issue documents, introduction of prudential norms and simplification of issue procedures. Companies are now required to disclose all material facts and risk factors associated with their projects while making public issue. All issue documents are to be vetted by SEBI to ensure that the disclosures are not only adequate but also authentic and accurate. SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures. Merchant bankers and all mutual funds including UTI have been brought under the regulatory framework of SEBI. A code of conduct has been issued specifying a high degree of responsibility towards investors in respect of pricing and premium fixation of issues. To reduce cost of issue, underwriting of issues has been made optional subject to the condition that the issue is not under-subscribed. In case the issue is under-subscribed i.e., it was not able to collect 90% of the amount offered to the public, the entire amount would be refunded to the investors. The practice of preferential allotment of shares to promoters at prices unrelated to the prevailing market prices has been stopped and private placements have been made more restrictive. All primary issues have now to be made through depository mode. The initial public offers (IPOs) can go for **book building** for which the price band and issue size have to be disclosed. Companies with dematerialised shares can alter the par value as and when they so desire.

As for measures in the secondary market, it should be noted that all statutory powers to regulate stock exchanges under the Securities Contracts (Regulation) Act have now been vested with SEBI through the passage of securities law (Amendment) Act in 1995. SEBI has duly notified rules and a code of conduct to regulate the activities of intermediaries in the securities market and then registration in the securities market and then registration with SEBI is made compulsory. It has issued guidelines for composition of the governing bodies of stock exchanges so as to include more public representatives. Corporate membership has also been introduced at the stock exchanges. It has notified the regulations on insider trading to protect and preserve the integrity of stock markets and issued guidelines for mergers and acquisitions. SEBI has constantly reviewed the traditional trading systems of Indian stock exchanges and tried to simplify the procedure, achieve transparency in

Book Building: It is a process of determining price of shares based on market feedback. In this process the issue price of the share is not fixed in advance. It is determined by offer of potential investors about the price they may be willing to pay for the issue.

QUESTIONS 18C

1. State the three main objectives for which SEBI was granted statutory recognition in 1992.

(i) ____

(ii) ____

(iii) ____

2. Give a specific term/name for the following:

(a) The prominent stock exchange enjoying nation wide coverage that commenced operations in 1994.

(b) The stock exchange that specially caters to small and medium-sized companies.

(c) The first organised stock exchange in India.

(d) The Act passed in the year 1956 for providing recognition of stock exchanges by the central government.

(e) The regulatory body of stock exchanges in our country granted statutory recognition in the year 1992.

3. List any three primary market reforms initiated by SEBI.

(i) ____

(ii) ____

(iii) ____

YOU HAVE LEARNT

- Financial market is the market that facilitates transfer of funds between investors/ lenders and borrowers/ users. It deals in financial instruments like bills of exchange, shares, debentures, bonds, etc. It provides security to dealings in financial assets, liquidity to financial assets for investors and ensures low cost of transitions and information.
- Financial Markets can be classified as (1) Money market and (2) Capital market.
- Money market refer to the network of financial institutions dealing in short term funds through instruments like bills of exchanges, promissory notes, commercial paper, treasury bills etc.
- Capital Market is an institutional arrangement for borrowing medium and long-term funds and which provides facilities for marketing and trading of securities. So it constitutes all long-term borrowings from banks and financial institutions, borrowings from foreign markets and raising of capital by issue various securities such as shares debentures, bonds, etc.

- The securities market has two different segments namely primary and secondary market.
- The primary market consists of arrangements for procurement of long-term funds by companies by fresh issue of shares and debentures.
- The secondary market or stock exchange provides a ready market for existing long-term securities.
- Stock exchange is the secondary market, which provides a place for regular sale and purchase of different types of securities like shares, debentures, bonds & government securities. It is an organised market where all transactions are regulated by the rules and laws of the concerned stock exchanges.
- The functions of a stock exchanges are to provide ready and continuous market for securities, information about prices and sales, safety to dealings and investment, helps mobilisation of savings and capital formation. It acts as a barometer of economic and business conditions and helps in better allocation of funds.
- Stock exchanges provide many benefits to companies, investors and the society as a whole. But they also suffer from limitations like exclusive speculation and fluctuation in prices due to rumours and unpredictable events.
- Along with genuine investment, at times, stock exchange transactions may be undertaken by persons as a speculation.
- There are 23 stock exchanges in India presently, including BSE, NSE and OTCEI.
- Stock Exchanges are regulated by the Securities Contracts (Regulation) Act and by SEBI. SEBI has initiated a number of reforms in the primary and secondary market to regulate the stock market. Documentary and procedural requirements for listing and trading have been made stricter and foolproof to protect investors' interest.

KEY TERMS

Call money Capital market
Certificate of deposit Commercial paper Financial Market
Money market New issue market NSE
OTCEI Primary market
Rolling settlement SEBI
Secondary market Speculation
Stock exchange Trade bill
Treasury bill

4 TERMINAL QUESTIONS

Very Short Answer Type Questions

1. What do you mean by 'Financial Market'?
2. Give four examples of credit instruments of the money market.
3. State the meaning of capital market.
4. List two advantages of stock exchanges to companies.
5. Mention the organisations that are part of the organised money market in India.

Short Answer Type Questions

6. Define money market and explain its importance in a modern economy.
7. What is capital market? How does it differ from money market?
8. Distinguish between primary market and secondary market.
9. How does the stock exchange helps in mobilizing savings and capital formation?
10. Describe the measures taken by SEBI to regulate the secondary market.

Long Answer Type Questions

11. Define stock exchange and explain its functions.

12. Explain the importance of stock exchanges from the points of view of companies and investors.

13. Explain the role played by SEBI in protecting investors' interests and controlling the business at stock exchange.
4. Give explanatory notes on (a) stock exchange in India; and (b) Regulations of stock exchanges.
15. Describe the two components of the securities market, in detail.

DO AND LEARN

1. Identify any two persons in your vicinity who are associated with the financial market/ stock exchanges, either as an investor or as a stockbroker. Talk to them and find out (i) how sale and purchase of securities takes place; (ii) what are the popular instruments traded in the market; and (iii) about recent SEBI/ government guidelines that may have affected their transactions.

2. Read the Business Section of a daily newspaper or a specialised Business Newspaper. Locate the segment where share prices of important stock exchanges are given. Select any five companies and record their share prices everyday for a period of there weeks. Observe their price movement and see how major events in the economic, political or social environment affect the prices of these shares. You may even get information about these share prices from the television.

ROLE PLAY

Sunita and Kavita are good friends. Kavita is very god-fearing kind, while Sunita was an enterprising person, having practical in approach. Read the following conversation.

Kavita :

Sunita :Hi, Sunita! What are you doing?

Hi, I am reading the newspaper - financial market page that gives us information about the shares price.

Kavita :

Sunita :

Kavita :

Sunita :
Shares, that is an area of big gambles.

No, not really! You must understand how it works.

Frankly speaking, I think this Capital market is all a gambling game and I don't see any use of them.

No, you are seriously mistaken; you do not know the importance of capital market. I will tell how it is needed for an individual and an economy.

You are required to play the role of Sunita and continue the conversation.