



Security market and stock exchange

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Abstract

In the 1990s, India's securities market expanded dramatically, leading to a rise in the country's direct equity ownership. Through their participation in mutual funds, a substantial number of households indirectly owned equity shares and debentures. To assist in determining the impact of the growth of the securities market on Indian Investor households, a comprehensive survey will be conducted. These are the objectives of this study: Estimate the number of households and individual investors who have invested directly or indirectly in the equity market through mutual funds. Describe the demographic, economic, financial, and ownership characteristics of the households and investors; Comprehend their investment preferences for equity and other market-available savings instruments, their perceptions of market risks, their market expectations, and the nature of their grievances and difficulties. Estimate the number of households that have refrained from investing in the equity market, describe their demographic characteristics, and investigate the reasons for their reluctance to invest in equity.

Keywords: stock exchange, income security, finance, trading, equity market

Introduction

In the 1990s, economic reforms in India helped integrate the Indian securities market into the mainstream of the Indian financial system. Consequently, the growth of individual investors' investments has become quite significant. This made it pertinent to have a first-hand in-depth view of the extent of public participation directly in the securities market or through mutual funds. The Development of Stock Markets in India – In 1875, the Bombay Stock Exchange and 23 other stock exchanges were founded in India. The traded securities included equity, debt, and derivatives including options, futures, and index. There are essentially three types of participants in the securities market: the issuer of securities, the investors in securities, and the intermediaries. The securities have two interdependent and inseparable segments: the primary (new issues) market and the secondary (stock) market. The primary market facilitates the issuance and sale of new securities, while the secondary market trades in previously issued securities. Over-the-counter (OTC) and exchange-traded markets were the two channels through which the secondary market operated. All trades that occur during a trading cycle (day=T) are settled at the same time (T+2 day) after a certain period of time. The National Stock Exchange (NSE) trades are cleared and settled by a clearing corporation. The clearing corporation functions as a counterparty and ensures settlement. The country's exchanges that offer a screen-based trading system. The trading system is connected to over 281 cities using VSAT technology. SEBI has 9,335 registered trading members as of the end of March 2006. NSE implemented a nationwide online fully automated screen-based trading system in order to provide efficiency, liquidity, and transparency (SBTS).

Currently, only the NSE and the Stock Exchange of Mumbai (BSE) offer trading in derivatives of securities. Despite the large number of companies listed on its exchanges, India's contribution to the global turnover in 2005 was a meagre 0.94 percent. India's market

capitalization as a percentage of GDP reached 56.1% by the end of 2004. In India, there are two depositories: NSDL and CDSL. They have been established to facilitate the electronic transfer of securities in real time. The number of dematerialized securities rose from billion at the end of March 2005 to 201.9 billion by the end of March 2006. The household sector accounted for 85.4% of gross domestic savings in 2004-05, as reported by the RBI. In 2005-06, this figure has decreased to 83.9%. In 2005-2006, they placed 47.4% of their savings in deposits, 24.2% in insurance/provident funds, 12.3% in small savings, and 7.2% in securities. Thus, the instruments that generate a fixed income are the most favoured by the household sector. It appears that mutual funds (MFs) are gaining popularity as an investment vehicle. This change in investor behaviour is a result of the evolution of a regulatory framework for mutual funds, tax breaks provided by the government, and investors' preference for passive investing. At the end of March 2006, the total assets under management had increased from 250 million rupees in 1964 to 2,318,620 million rupees. The resources mobilised by the MFs have increased from Rs.112,440 million in 1993-94 to Rs.527,800 million in 2005-06. In 2005-06, the total value of exchange-traded derivatives increased to Rs.48,242,592 billion from Rs.25,641,269 billion in 2004-05. In 2005-06, NSE was the market leader in India, contributing 99.9% of the total turnover. SEBI issued the Disclosure and Investor Protection (DIP) guidelines for the benefit of investors. These guidelines contain a comprehensive set of requirements for issuers/intermediaries, with the overarching goal of ensuring that all relevant parties observe high standards of integrity and fair dealing. DEA, DCA, SEBI, and stock exchanges have established investor grievance cells to address investor complaints. To cover investor claims, the exchanges maintain investor protection funds. Government Securities Market: Non-competitive bids from retail investors are accepted to broaden the investor pool. In addition, to encourage retail investors to invest in

government securities, RBI authorised certain entities to provide custody accounts (Constituent SGL). The elimination of TDS on government securities and stamp duty on the transfer of demat debt securities are additional measures. The purpose of the study was to estimate the number of households and the population of individual investors, as well as their economic and demographic characteristics, portfolio size, and investment preferences for stocks and other saving instruments. The study was also intended to collect information from households regarding their risk perceptions, experiences investing in the security market, return on investment, and similar matters. Awareness of investor rights and experiences with grievance redress mechanisms were also to be covered, along with indications of investors' future investment plans and their expectations from the securities market. In addition, the study provided estimates of non-investor households and population, as well as their economic and demographic profile, pattern of investment in various instruments, and reasons for not investing in the equity market. Lastly, on the basis of the study, to determine the measures to be adopted to improve the level of confidence of investors in the securities market. The securities have two interdependent and inseparable segments: the primary (new issues) market and the secondary (stock) market. The primary market facilitates the issuance and sale of new securities, while the secondary market trades in previously issued securities. On the primary market, securities are issued by public limited companies or government agencies. In this type of market, resources are mobilised through either a public offering or a private placement. It is a public issue if anyone can subscribe for it, whereas it is a private placement if it is only made available to a select group of individuals. Corporate entities, which primarily issue debt and equity instruments, and the government (both federal and state), which issues debt securities, are the two primary types of issuers of securities (dated securities and treasury bills). Participants on the secondary market are able to adjust their holdings in response to changes in their assessment of risks and returns. Once the new securities are issued in the primary market they are traded in the stock (secondary) market. Over-the-counter (OTC) and exchange-traded markets were the two channels through which the secondary market operated. OTC markets are informal markets where trades are negotiated. The majority of government security transactions occur on the OTC market. On the OTC market, all spot trades in which securities are exchanged for immediate delivery and payment occur. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. On the OTC market, all spot trades in which securities are exchanged for immediate delivery and payment occur. The alternative is to use the infrastructure provided by stock exchanges to trade. There are 23 exchanges in India, and they all adhere to a standardised settlement period. All trades that occur during a trading cycle (day=T) are settled at the same time (T+2 day) after a certain period of time. The National Stock Exchange (NSE) trades are cleared and settled by a clearing corporation. The clearing corporation functions as a counterparty and ensures settlement. Almost all transactions in the capital market segment are settled via demat delivery. Additionally, the NSE offers a formal trading platform for the trading of a vast array of debt securities, including

government securities. Forward market is a subset of the secondary market in which securities are traded for future delivery and payment. Futures and Options market is a subset of the forward market. Currently, only the NSE and the Stock Exchange of Mumbai (BSE) offer trading in derivatives of securities.

Over the past ten years, both the size and depth of global stock markets have increased. As shown in Table 1-3, total market turnover increased from \$29,70 trillion in 2003 to \$47,390 trillion in 2005. It is significant to note that the United States alone accounted for 45.46 percent of global revenue in 2005. Despite the large number of companies listed on its exchanges, India's contribution to the global turnover in 2005 was a meagre 0.94 percent. In 2005, the market capitalization of all listed companies on all markets was \$43.64 trillion, up from \$38.90 trillion in 2004. US market capitalization decreased from 41.96 percent at the end of 2004 to 38.95 percent at the end of 2005, while Indian listed companies accounted for 1.27 percent of total market capitalization in 2005. As shown in Table 1-4, there has also been an increase in market capitalization as a percentage of GDP in several major country groups. However, the increase has not been uniform across nations. As of the end of 2004, market capitalization as a percentage of GDP was highest in high income countries at 108.9% and lowest in middle income countries at 43.0%. India's market capitalization as a percentage of GDP reached 56.1% by the end of 2004. However, the turnover ratio, a measure of liquidity, was roughly the same for both high- and low-income countries, at 14% and 107.6%, respectively. As of the end of 2005, there were 28,001 listed companies in high-income countries and 14,117 in middle-income countries.

The number of available derivatives instruments has increased. SEBI initially permitted only index futures contracts based on the S&P CNX Nifty Index and the BSE-30 (Sensex) Index. This was followed by approval for trading options based on these indices as well as options on individual securities and futures on interest rates derivative instruments (91day Notional T-Bills, 10 year Notional 6% coupon bearing, and zero-coupon bonds). There are now futures and options based on the benchmark indexes S&P CNX Nifty, CNX IT Index, and Bank Nifty Index, in addition to options and futures based on individual stocks (122 stocks). On June 1, 2007, futures and options contracts were introduced for trading on the CNX Nifty Junior and CNX 100 indices in the F&O segment. Since its inception, the derivatives segment's revenue has increased significantly. In the global market, NSE ranks first (1st) in the world in terms of number of contracts traded in the Single Stock Futures, second (2nd) in Asia in terms of number of contracts traded in equity derivatives instrument. Since its inception, NSE has established itself as the country's sole market leader in this segment, with a 98% market share. As of March 30, 2007, 68 members of the F&O segment offered investors Internet-based trading. Approximately 167 lakh trades worth Rs. 922,887.03 crore (US \$211,719,90 million) or 12.55 percent of the total trading volume in this segment were routed and executed online. The F&O segment of the NSE reported a total trading value (notional) of Rs.7,356,271 crore (US \$1,687,605 million) in 2006-07, a 52.49 percent increase from Rs.4,824,250 crore (US \$ 1,687,605 million) the previous year.

Regulatory framework

The four main legislations governing the securities market are (a) the SEBI Act, 1992 (b) the Companies Act, 1956 (c) the Securities Contract (Regulation) Act, 1956 and (d) the Depositories Act, 1996.

SEBI Act, 1992

The SEBI Act, 1992 was enacted to empower SEBI with statutory powers for (a) protecting the interests of investors in securities (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuing capital and all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned participants and adjudicate offences under this Act. It has powers to register and regulate all the market intermediaries. Further it can also penalize them in case of violations of the provisions of the Act, Rules and Regulations made there under. SEBI has full autonomy and authority to regulate and develop an orderly securities market.

Securities Contract (Regulation) Act, 1956

It provides for direct and indirect control of virtually all aspects of the securities trading including the running of stock exchanges with a aims to prevent undesirable transactions in securities. It gives the Central Government regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the requirements prescribed by the Central Government. The stock exchanges frame their own listing regulations in consonance with the minimum listing criteria set out in the Rules.

Depositories Act, 1996

The Depositories Act, 1996 provides for the establishment of depositories for securities to ensure transferability of securities with speed, accuracy and security. Provisions have been made for (a) dematerializing the securities in the depository mode, and (b) making securities of public limited companies freely transferable subject to certain exceptions (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without moving the securities from persons to persons. The Act has made the securities of all public limited companies freely transferable, restricting the company's right to use discretion in effecting the transfer of securities, and the transfer deed and other procedural requirements under the Companies Act have been dispensed with.

Companies Act, 1956

It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standards of disclosure in the public issues, particularly in the fields of company management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

Rules, regulations and regulators

The responsibility for regulating the securities market is shared by the Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and SEBI. The orders of SEBI under the securities laws are appealable before the Securities Appellate Tribunal (SAT). The SEBI Act and the Depositories Act are mostly administered by SEBI. SEBI was given full authority and jurisdiction over the securities market under the Act, and was given concurrent/delegated powers for various provisions under the Companies Act and the SCRA.

DIP guidelines

In the interest of investors, SEBI issued the Disclosure and Investor Protection (DIP) guidelines. These guidelines contain a substantial body of requirements for issuers/intermediaries, with a broad intention to ensure that all the concerned entities observe high standards of integrity and fair dealing. The guidelines cast a responsibility on the lead managers to issue a due diligence certificate, stating that they have examined the prospectus and that it brings out all the facts and does not contain anything wrong or misleading. Issuers are now required to comply with the guidelines and then access the market. The companies can access the market only if they fulfill minimum eligibility norms in terms of their track record of distributable profits and net worth.

Screen based trading

Prior to setting up of NSE, the trading on stock exchanges in India used to take place through an open outcry system. This system did not allow immediate matching or recording of trades. This was time consuming, imposed limits on trading. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully automated screen-based trading system (SBTS). In this system a member can punch into the computer, quantities of securities and the prices at which he desires to transact and the transaction is executed as soon as it finds a matching sale or buy order from a counter party. It allows a large number of participants, irrespective of their geographical locations, to trade with one another simultaneously, improving the depth and liquidity of the market. Given the efficiency and cost effectiveness delivered by the NSE's trading system, it became the leading stock exchange in the country in its very first year of operation. This forced the other stock exchanges to adopt SBTS. As a result, open outcry system has disappeared from India. Today, India can boast that almost 100% trading takes place through electronic order matching. Technology has been harnessed to carry the trading platform to the premises of brokers. NSE carried the trading platform further to the PCs in the residence of investors through the internet and to hand held devices through (WAP) for convenience of mobile investors. This has made a huge difference in terms of equal access to investors in a geographically vast country like India.

Trading cycle

Initially, the trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. The exchanges, however, continued to have different weekly trading cycles, which enabled shifting of positions from one exchange to another. Rolling settlement on T+5 basis was introduced in respite of specified scrips reducing the trading cycle to one day. It was made mandatory for all exchanges to follow a uniform weekly trading cycle in respect of scrips not under rolling settlement. All scrips moved to rolling settlement from December, 2001. The settlement period has been reduced progressively from T+5 to T+3 days. Currently, T+2 day-settlement cycle is being followed.

Derivatives trading

The market presently offers index futures and index options on S&P CNX Nifty, CNX IT Index, CNX Bank Nifty Index, BSE 30 Index and stock options and stock futures on individual stocks (in NSE 122 as of October, 2006) and futures in interest rate products like notional 91day T-Bills and notional 10 year bonds.

Depositories act

The Depositories Act, 1996 was passed to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed and accuracy. This act brought in changes by (a) making securities of public limited companies freely transferable subject to certain exceptions (b) dematerializing of securities in the depository mode, in order to promote dematerialization, the regulator has been promoting settlement in demat form in a phased manner in an ever-increasing number of securities. There are two depositories in India, viz. NSDL and CDSL. They have been set up to provide instantaneous electronic transfer of securities. The number of dematerialized securities increased to 201.9 billion at the end of March 2006 from 147.7 billion at the end of March, 2005. As on the same date, the value of dematerialized securities was Rs.27,147 billion and the number of investor accounts was 9,421,587.

Investment strategies

People lose money in stock markets more because of their own mistakes, than any market turmoil and other such things. For instance, it has generally been observed that equity investments are often guided by greed and investors seldom do their homework before putting their hard-earned money in stock markets. Besides, they often resort to speculation and keep 'timing the market', which has not proven to be a great strategy. Lots of investors also presume that the market will only go northwards and the bull run will never end. But that never happens. Not in any market of the world. But that's how it is. Here are 10 such mistakes that equity investors generally make:

Guided by grid

Many investors have been losing money in stock markets owing to their inability to control greed and fear. The lure of quick wealth is difficult to resist, particularly in a bull market. Greed augments when investors hear stories of fabulous returns being made in the stock market in a short period of time and, thus, lose their hard-earned money in many cases.

Following herd mentality

Following herd mentality is another reason for the investors' losses. "It has been witnessed that the typical buyer's decision is heavily influenced by the actions of his acquaintances, neighbors or relatives. So, if everybody around is investing in a particular stock, the tendency for potential investors is to do the same. But this strategy may backfire in the long run," says Ashish Kapur, CEO, Invest Shoppe India Ltd.

Resorting to speculation

Investors also face losses because they speculate and buy shares of unknown companies. They should, therefore, avoid relying on random tips and go for long-term gains only.

Lack of research

Proper research should be undertaken before investing in stocks. But this is rarely done. Investors generally go by the name of a company or the industry they belong to. But this is not the right way of putting one's money into the stock market. "Therefore, if one doesn't have time or temperament for studying the markets, one should always take the help of a suitable financial advisor.

Creating leveraged positions

Many investors suffer from creating heavy positions in the futures segment without really understanding the risks involved. Instead of creating wealth, however, these investors burn their fingers very badly in case the sentiment in the market reverses.

Panic selling

In a bear market, investors panic and sell their shares at rock bottom prices. Trading on the bourses was suspended on May 17, 2004, May 18, 2006 and recently on January 22, 2008. Investors who had taken speculative positions lost heavily when blood was on the street. Even investors who had the capacity to hold on to their investments, lost faith in the markets and sold their investments in a hurry, thus incurring heavy losses. Market Timing Many investors try to time the market. But this has not proven to be a great strategy. Historically, in fact, it has been witnessed that even great bull runs have shown bouts of panic moments. The volatility witnessed in the markets has inevitably made investors lose money despite the great bull run. Therefore, only prudent investors who put in money systematically, in the right shares and hold on to their investments patiently, have made outstanding returns. so it's not 'timing the market', but 'time in the market' which creates wealth. Hence, it is prudent to have patience and always keep a long-term broad picture in mind. Putting all eggs in one basket Another mistake which investors generally make is non-diversification of their portfolio. They generally put all their money in limited and favorite stocks which are in momentum. So, investors should diversify their portfolio across industries and size of the companies. Also, it is important to diversify across asset classes – equities, real estate, bonds, commodities, cash etc.

Avoiding financial planning

Investors also do not apply financial planning practices in their investment approach. They should follow an asset allocation model and invest only in long-term funds in the equity markets. They should also keep rebalancing their overall portfolio from time to time to keep their exposure equity markets at the desired ratio of the total portfolio.

No monitoring of portfolio

We are living in a global village. Any important event happening in any part of the world has an impact on our financial markets. Hence, we need to constantly monitor our portfolio and keep affecting the desired changes in it. If one can't review one's portfolio due to time-constraint or lack of knowledge, they should take the help of a financial advisor.

Limitations

The advertising and promotion of the capital market are given little weight, and there is no assurance that investments and returns will be secure. No awareness or training programmes are conducted so that investors and non-investors may acquire knowledge about the securities market. Our country's macroeconomic situation remains underdeveloped. Retail clients are not provided with current and timely information by brokers. Less transparency exists between investors and companies. Extensive formalities and procedures for investing in the securities market. People are typically risk-averse and prefer traditional fixed income securities due to their assured returns. Despite the existence of rules and regulations designed to prevent fraud, the possibility of future fraud cannot be ruled out. Systematic risk cannot be diversified by holding a variety of security portfolios. High transaction costs for securities transactions. Unstable broker firm.

Conclusion

After the 1990s reforms, the SEBI Act of 1992, the repeal of the Capital Issues Act of 1947, and the research conducted by NCAER and the National Stock Exchange, retail investors' confidence in the securities market has increased dramatically. Numerous non-investors or potential investors have entered the securities market, either directly or indirectly, as a result of the booming economy and the presence of a stable government. SEBI's initiatives in disclosure and investor protection, the safety of retail investors, the redress of complaints, and the prevention of fraud have allowed investors to remain in the market and non-investors to participate in the primary and secondary markets. However, retail investor participation is very low due to a number of factors, including illiteracy, low per capita income, uneven distribution of income and wealth, alternative investment avenues such as the real estate market, and the conservative nature of households, which all contribute to lower savings and, by extension, investment in the securities market. 30% of total trading volume indicates that Foreign Institutional Investors (FIIs) continue to control the market. However, with India on the verge of becoming a developed nation due to the government's massive reforms and policy initiatives to improve the macroeconomic situation, the future of retail investment in the securities market is bright.

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