UNIT- I

Introduction to Investment: Investment Avenues, Attributes, Investor V/s speculator, Features of a good Investment, Investment Process. *(Explanation refer Punithavathy Pandian text book)*

Financial Instruments: Money Market Instruments, Capital Market Instruments, Derivatives. Securities Market: Trading & Settlement Procedure, Stock Market Indicators- Indices of Indian Stock Exchanges and its computation (Theory and problems)

MEANING

- In **ordinary sense** investment means some monetary commitment.
- In **economic sense** investment is the net additions made to the nation's capital stock that consists of goods and services that are used in the production process.
- In **financial terms** investment is the allocation of money to assets that are expected to yield some gain over a period of time.
- **Investment= Current Income + Capital Appreciation**

Points	Investors	Speculators	Gambler
Time Horizon	Plans for a longer time horizon (1-few years)	Plans for a shorter period (days months)	Plans for a very short period(sec days)
Risk	Assumes moderate risk	Willing to undertake high market risk	Employs artificial risk
Return	Moderate return with limited risk	High return for high risk	high returns always expects to win
Decision	Considers fundamental factors and evaluates company performance	Considers hearsays inside information and also depends on Market behaviour	Biased
Funds	Uses his own funds avoid borrowed funds	Own funds + Borrowed funds	own funds + Gambled funds
Attitude of the parties	Cautious and conservative	Daring and careless	Aggressive
Stability of income	Very stable	Uncertainty and erratic	Probabilistic

Investment Attributes

1. Rate of return- risk and time

$$R=\frac{[\text{end period value} - \text{beginning period}]+\text{dividend}}{\text{Beginning period value}}$$

2. Risk
3. Marketability/ Liquidity
4. Taxes
5. Convenience
6. Safety- G sec's- T- Bill

8.Duration- Time value

9. Concealibility
10. Hedge against inflation

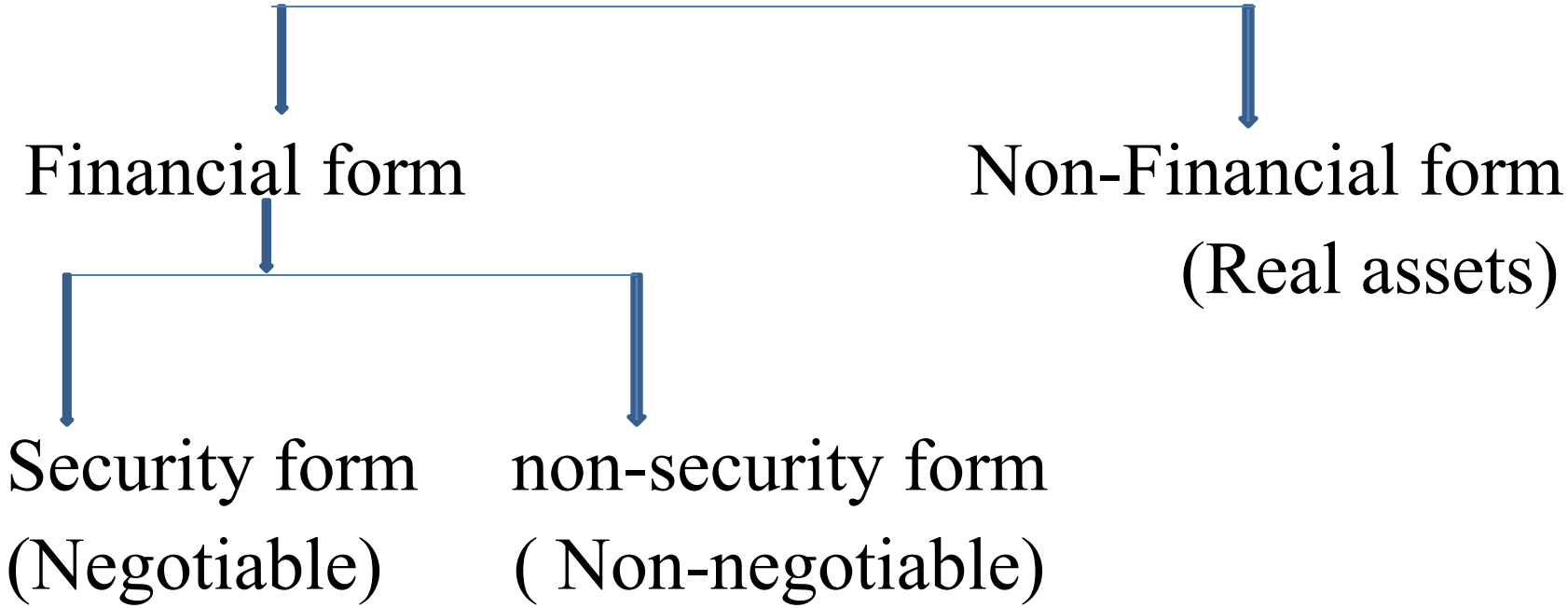
TYPES OF INVESTMENTS/ AVENUES

1. FINANCIAL FORM- a. Security/ negotiable and b. Non-Security/ Non- negotiable
- a. Equities, Hybrids, Bonds/ Debentures, G-secs, MMI's(T- Bills, CP's, CD's, MMF's), Derivatives
- b. PO savings, Bank savings, Social security savings, Contractual Savings

2. NON- FINANCIAL FORM/ REAL ASSETS- Real estate, Gold, Silver, Antiques, Art and paintings

FORMS OF INVESTMENT

TYPES OF INVESTMENTS



Financial investment

- Equity shares
- Debentures
- Bond
- Government securities
- Treasury bills
- Commercial papers
- Certificate of deposit
- Life insurance
- All money mkt securities
- Post office deposits
- Mutual funds
- Bank deposits
- Company deposits
- Derivatives

Non-Financial form

- Real estate
- Gold & silver
- Antiques
- Art
- Paintings

Security forms of investment

- Preference share
- Bonds
- Debenture
- Government security
- IVP's & KVP's
- Money market instruments

Non- Security forms of investment

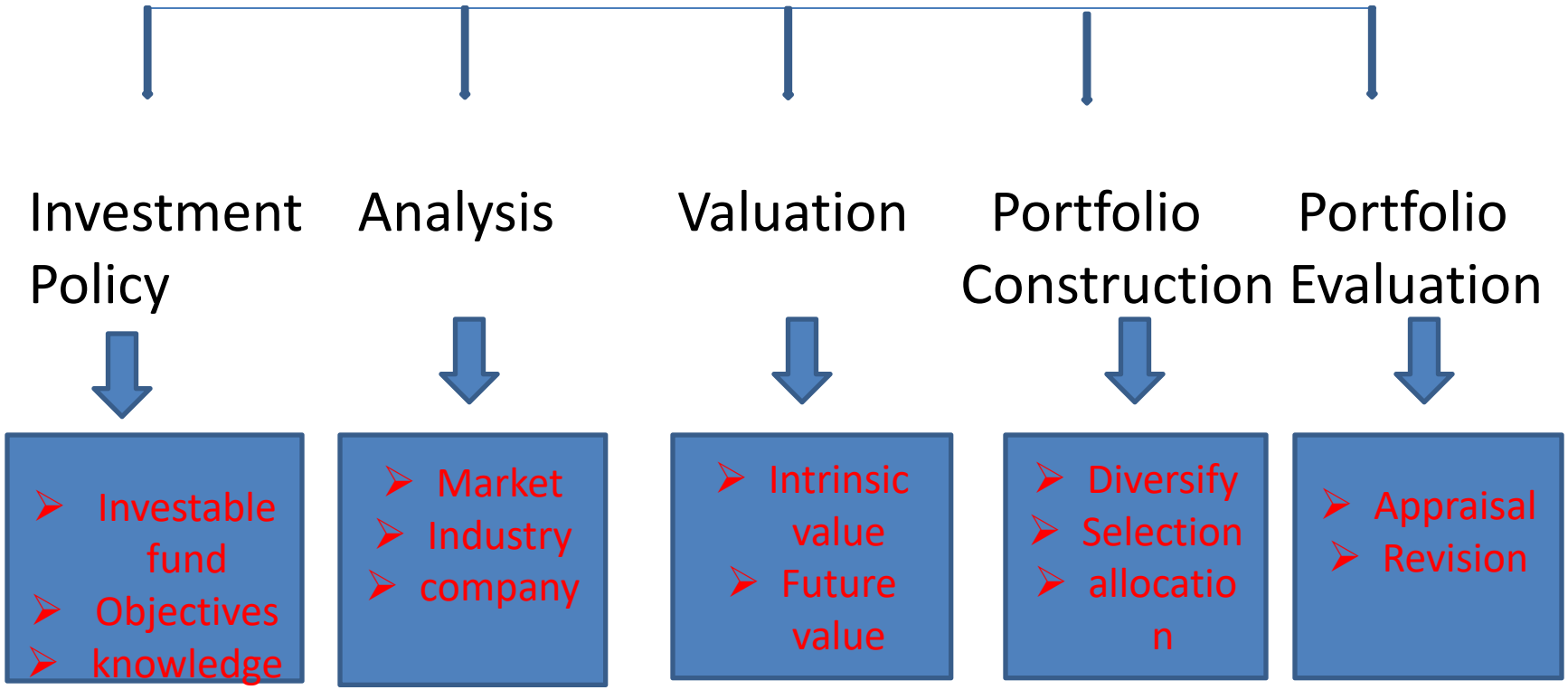
- Contractual savings
- Commercial bank deposits
- Social security fund
- P O Deposit
- Company deposits
- Real estate investment

Investment Process

- 1.Investment Policy- Investible fund, Objectives, Knowledge
- 2. Analysis- Economic, Industry and Company
- 3. Valuation- Intrinsic Value, Future Value
- 4. Portfolio Construction- Diversification, Selection, Allocation
- 5. Portfolio Evaluation- Appraisal, Revision

Investment Process

It involves a series of activities lead to the purchase of security or other invest alternatives. It is divided into 5 stages



MODES OF ISSUING SECURITIES

- Public Issue or Initial Public Offer (IPO)/ Prospectus
- Offer for Sale/ Bought out deals
- Private Placement
- Right Issue
- Book Building

Prospectus/ IPO is issued and a public appeal is made to subscribe the new shares/debentures issued by the company. Shares are allocated in response to the application received. Some companies sell shares directly to public and some by stock brokers. The company appoints an advertising agency to advertise its issue of shares.

Advantages

access to investment , Increased transparency , Can raise additional funds in the future through secondary offerings, can attract and retain better management, lower cost of capital.

Dis-advantages

Increase the company's exposure Expensive, disclosure, dilution of voting rights, time consuming, rigid governance, regulations and agency problems.

- **Offer for sale** (OFS)/ A **bought out deal** is a method of offering securities to the public through a sponsor or underwriter (a bank, financial institution, or an individual). The securities are listed in one or more stock exchanges within a time frame mutually agreed upon by the company and the sponsor. This option saves the issuing company the costs and time involved in a public issue. The cost of holding the shares can be reimbursed by the company, or the sponsor can offer the shares to the public at a premium to earn profits.
- Only promoters or shareholders holding more than 10 per cent of the share capital in a company can come up with such an issue.

Advantages:

- Speedy sale – The bought out deals offer a mechanism for speedy sale of securities involving lower issuing cost.
- Freedom – The bought out deals offer freedom for promoters to set a realistic price & negotiate the same with the sponsor.
- Investor protection – The bought out deals facilitates better investor protection as the sponsors are rigorously evaluated and appraised by the promoters before off-loading the issue
- Quality offer – The bought out deals help in improving the quality of capital flotation and primary market offering.

Disadvantages

- Sponsors may take control of the company as they own large number of shares.
- When markets are down sponsors may incur losses.
- The risk of market manipulation by the sponsor such as insider trading is high.
- Sponsors can make large profits at the expense of small investors.

Private placement Private placement (or non-public offering) is a funding round of securities which are sold not through a public offering, but rather through a **private** offering, mostly to a small number of chosen investors. Generally, these investors include friends and family, accredited investors, and institutional investors.

ADVANTAGES-PP

Allow you to **choose your own investors** - this increases the chances of having investors with similar objectives to you and means they may be able to provide business advice and assistance, as well as funding

Allow you to **remain a private company**, rather than having to go public to raise finance.

Provide **flexibility** in the amount and type of funding .

- Allow you to make a **return on the investment** over a longer time period - as private placement investors will be prepared to be more patient than other investors, such as venture capitalists.
- Require **less investment** of both money and time than public share flotation.
- Provide a **faster turnaround** on raising finance than the venture capital markets or public

DIS-ADVANTAGES-PP

- **Limited number of potential investors**
- Place it at **substantial discount** to compensate investors for their greater risk and longer-term returns.

- **Right shares** means new shares are offered to existing shareholders on the pro rata basis. When company wants to raise additional capital, securities are first offered to existing shareholders. If the shareholders do not want to buy the shares. The company can sell the shares to outside public.

BOOK BUILDING

- Book building is the process by which an underwriter attempts to determine the price at which an initial public offering (IPO) will be offered. An underwriter, normally an investment bank, builds a book by inviting institutional investors (such as fund managers and others) to submit bids for the number of shares and the price(s) they would be willing to pay for them.

BOOK BUILDING PROCESS



Advantages:

- The most efficient way to price the share in the IPO market;
- The price of the share is finalized by the aggregate demand by investors, not by the fixed price set by the company management.

Dis-advantages:

- High cost involved in the book-building process as compared to the fixed-price mechanism;
- The time period is also more in the book booking process as compared to the fixed-price mechanism.
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List of Approved Stock Exchanges in India

1. U.P. Stock Exchange, Kanpur
2. Vadodara Stock Exchange, Vadodara
3. Koyambatour Stock Exchange, Coimbatore
4. Meerut Stock Exchange, Meerut
5. Mumbai Stock Exchange, Mumbai
6. Over the Counter Exchange of India, Mumbai
7. National Stock Exchange, Mumbai
8. Ahmedabad Stock Exchange, Ahmedabad
9. Bangalore Stock Exchange, Bangalore
10. Bhubaneshwar Stock Exchange, Bhubaneshwar
11. Calcutta Stock Exchange, Kolkata
12. Cochin Stock Exchange, Cochin
13. Delhi Stock Exchange, Delhi
14. Guwahati Stock Exchange, Guwahati
15. Hyderabad Stock Exchange, Hyderabad
16. Jaipur Stock Exchange, Jaipur
17. Canara Stock Exchange, Mangalore
18. Ludhiana Stock Exchange, Ludhiana
19. Chennai Stock Exchange, Chennai
20. M. P. Stock Exchange, Indore
21. Magadh Stock Exchange, Patna
22. Pune Stock Exchange, Pune
23. Capital Stock Exchange Kerala Ltd.,Thiruvananthapuram, Kerala

REGULATORY FRAMWORK

- Governed by SEBI, 1992 and framework provided under SCRA, 1956.
- Its a three tier system comprising of:

  MINISTRY OF FINANCE

  THE SEBI

  THE GOVERNING BODY

LISTING OF SECURITIES

- Listing means the admission of securities of a company to trading on a stock exchange. Listing is not compulsory under the Companies Act. It becomes necessary when a public limited company desires to issue shares or debentures.
- The major objectives of listing are:
- 1. To provide ready marketability and liquidity of a company's securities.
- 2. To provide free negotiability to stocks.
- 3. To protect shareholders and investors interests.
- 4. To provide a mechanism for effective control and supervision of trading.

Listing requirements

- A company which desires to list its shares in a stock exchange has to comply with the following requirements:
- 1. Permission for listing should have been provided for in the Memorandum of Association and Articles of Association.
- 2. The company should have issued for public subscription at least the minimum prescribed percentage of its share capital (49 percent).
- 3. The prospectus should contain necessary information with regard to the opening of subscription list, receipt of share application etc.
- 4. Allotment of shares should be done in a fair and reasonable manner. In case of over subscription, the basis of allotment should be decided by the company in consultation with the recognized stock exchange where the shares are proposed to be listed.
- 5. The company must enter into a listing agreement with the stock exchange. The listing agreement contains the terms and conditions of listing. It also contains the disclosures that have to be made by the company on a continuous basis.

Delisting

- Delisting involves removal of listed securities of a company from a stock exchange where it is traded on a permanent basis. It may be (a) compulsory or
- (b) Voluntary

Functioning of Stock Exchanges

- In **India**, all trading is regulated by SEBI.
- **Stock exchange** provides a platform by which savings get channelized into the most productive investment proposals, which leads to capital formation & economic growth.
- There are **23 stock exchanges** in India. Among them, two are national level stock exchanges namely BSE and NSE. The rest 21 are Regional Stock Exchanges (RSEs).

BSE

- Established as The NATIVE STOCK AND SHARE BROKER”S ASSOCIATION, recognised in 1857.
- Recognised as BSE in 1875
- it is Asia's oldest stock exchange. The BSE is the world's 10th largest stock exchange with an overall market capitalization of more than US$2.2 trillion on as of April 2018.
- BSE Ltd is now synonymous with Dalal Street
- Historically an open outcry floor trading exchange, the Bombay Stock Exchange switched to an electronic trading system developed by CMC Ltd. in 1995.
- This automated, screen-based trading platform called BSE On-Line Trading (BOLT) had a capacity of 8 million plus orders per day.
- Trading on the BOLT System is conducted from Monday to Friday between 9:15 a.m. and 3:30 p.m. normally.

ORDER TYPES

- Best rate order
- Discretionary order
- Stop- loss order
- Limit order
- Buy stop/ sell stop order
- Time base order- good till day, immediate or cancel order
- Market rate order

Secruties GROUPS

- The **BSE stock groups** are categorised into six **groups**. They are A, B, T, S, TS, and Z. This categorisation is done based on the size, liquidity, and exchange compliance of the companies.
- The A group contains the list of the most popular stocks. Stocks that are actively traded.
- The "F" Group represents the Fixed Income Securities.
- The "T" Group represents Securities which are settled on a trade-to-trade basis as a surveillance measure. (Physical delivery)
- Trading in Government Securities by the retail investors is done under the "G" group.

- The 'Z' group/ Illiquid shares was introduced by BSE in July 1999 and includes companies which have failed to comply with its listing requirements and/or have failed to resolve investor complaints and/or have not made the required arrangements with both the depositories, viz., Central Depository Services Ltd. (CDSL) and National Securities Depository Ltd. (NSDL) for dematerialization of their securities.
- B category includes stocks which don't form part of any of the above Equity groups.
- F group which denotes the Debt market segment.
- M/MT group consist of stocks forming part of BSE's SME (Small & Medium enterprise)
- E group consisting of ETF's (Exchange Traded Funds)

- Margins at BSE- MTM, Special margin, Concentration, adhoc and additional volatility margin
- Surveillance System at BSE- Price surveillance and Pre monitoring
- Settlement system- Fixed and
  Rolling settlement- T+n

NSE

- National Stock Exchange of India Limited is the leading stock exchange of India, located in Mumbai, Maharashtra. NSE was established in 1992 as the first dematerialized electronic exchange in the country.
- **Market cap:** 582,175.81 crores
- **No. of listings:** 1,952
- **Location:** Mumbai, India
- **Owner:** National Stock Exchange of India Limited
- **Founded:** 1992
- **Indices:** NIFTY 50; NIFTY Next 50; NIFTY 500

Securities Categorisation

- Stock are classified into three categories on the basis of their liquidity and impact cost.
- The Stocks which have traded at least 80% of the days for the previous six months shall constitute the Group I and Group II.
- Out of the scrips identified above, the scrips having mean impact cost of less than or equal to 1% are categorized under Group I and the scrips where the impact cost is more than 1, are categorized under Group II.
- The remaining stocks are classified into Group III.
- The impact cost is calculated on the 15th of each month on a rolling basis considering the order book snapshots of the previous six months. On the basis of the impact cost so calculated, the scrips move from one group to another group from the 1st of the next month.
- *For securities that have been listed for less than six months, the trading frequency and the impact cost are computed using the entire trading history of the security.*

- Segments at NSE- CM, WDM and F & O segment.

  OTCEI: The **Over-The-Counter Exchange of India** (OTCEI) is an electronic stock exchange based in India that consists of small- and medium-sized firms aiming to gain access to overseas capital markets, like electronic exchanges in the U.S., such as the NASDAQ. There is no central place of exchange, and all trading occurs through electronic networks.

Features of the Over-The-Counter Exchange of India (OTCEI)

- **Stock Restrictions:** Stocks that are listed on other exchanges will not be listed on the OTCEI and conversely, stocks listed on the OTCEI will not be listed on other exchanges.
- **Minimum Capital Requirements:** The requirement for the minimum issued equity capital is 30 lakh rupees.
- **Large Company Restrictions:** Companies with issued equity capital of more than 25 crore rupees are not allowed to be listed.
- **Member Base Capital Requirement:** Members must maintain a base capital of 4 lakh rupees to continue to be listed on the exchange.

Trading system is a screen based on with a left & right screen – buy & sell counters by quoting in the ascending order. Once the deal is struck a doc. called CR(counter receipt) is generated in two's . It contains the details of transaction no. , names of previous holder & new holders , date & time of transaction , price & value of transaction name of the details etc.,

The CR is transferred in his own name called 'TCR' & the sale confirmation slips (SCS) is given to the investor. Then the 'TD' is given both to the buyers & sellers in separate. Once the value is paid the investor receives the original/ permanent CR's.

Settlement system– 5 days cycle , forward trading is not permitted on OTCEI (must be squared) certificates are issued within a fortnight , once the deal is struck CR,s are issued, it is verified by registrar and thus the transfer is effected within 7 days.

Market making concept -3 types

1. Compulsory market making
2. Additional market making
3. Voluntary market making

Compulsory market making – The sponsor is responsible for market making for a period of 3 yrs from date of public trading . After 3 yrs period the sponsor can withdraw from this process on conduct. That another compulsory market is present for the scrip. He can also terminate from it if the scrip has incurred cash loss for 3 yrs / insolvency of the company /or if the company's prospects are bleak.

Even after termination if the co,. Regains it can trade it's sec's. The compulsory & additional MM's must posses 5% of public offer. If the reserves fall below 1% they should not offer sell quotes.

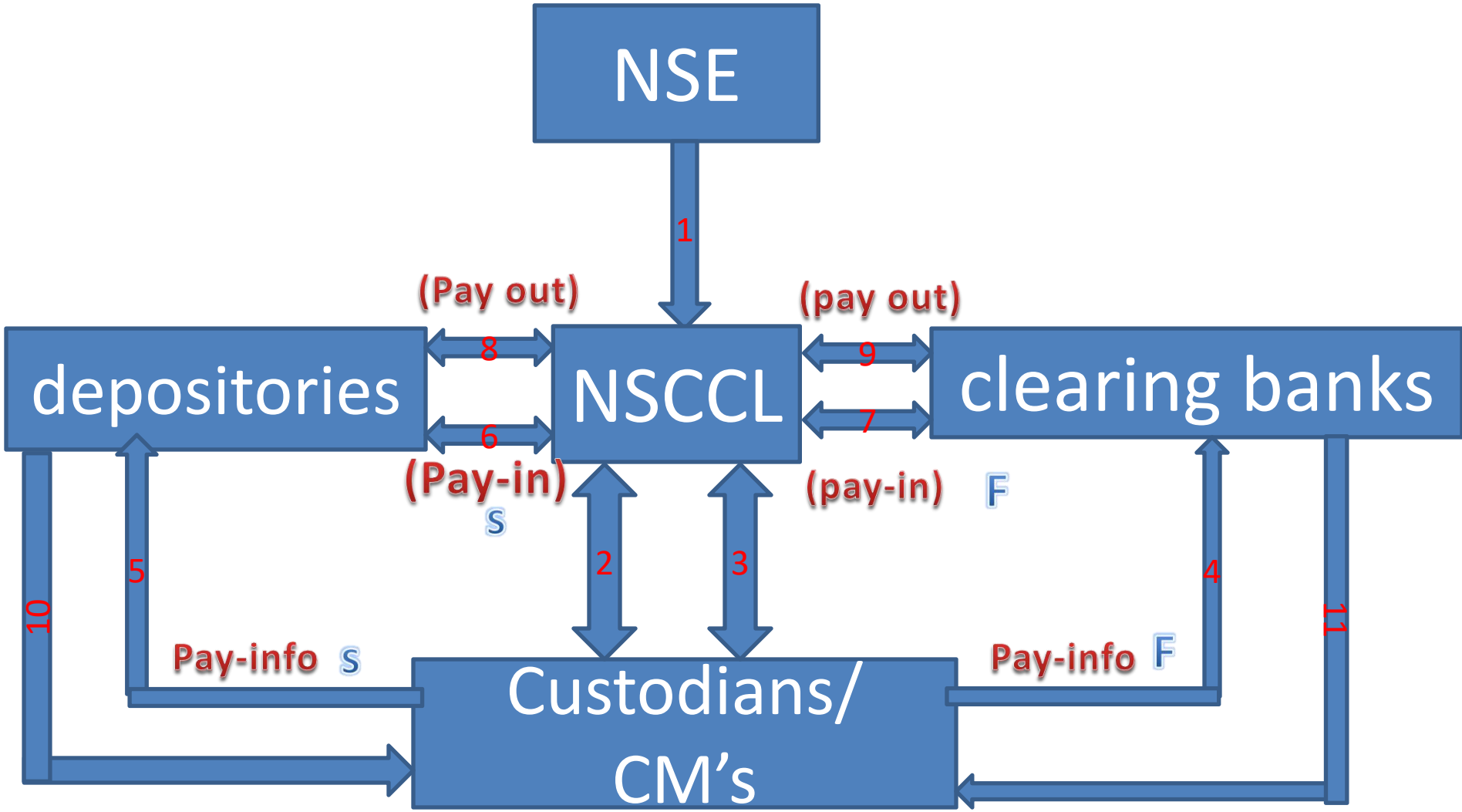
Additional MM -Appointed for < 1 year, they can be > 1 in no.

Voluntary MM- offered by the member , once offered he must continue at least for 3 months from the date of commencement..

Present situation ('OTCEI is in doldrums' explain)

1. Sluggish growth
2. Lack of liquidity
3. Speculation
4. Un organized trades etc.,

Clearing and settlement process



NSDL- national securities depository limited

NSDL was registered by SEBI on June 7th 1996,

It is an organization promoted by the IDBI, UTI & the NSE ltd , to provide electronics depository facilities for securities traded in the equity & debt market.

Functioning :

1. Enables surrender & withdrawal of sec's to & form of depository.
2. Maintains investors holdings in electronic form.
3. Effects settlement of sec's traded on exchanges
4. Carries out settlements of trades that have not been done on the S.E 's .

Any bank ,custodian ,register stock brokers , NBFC or fin instant. Can become a depositary Company, but their min. networth must be Rs 50 lacs .& has to pay a security deposit of Rs 10 lacs & administration fee of Rs 25000 to the NSDL

Advantages – sec's electronic form , prevents theft, one day settlement.

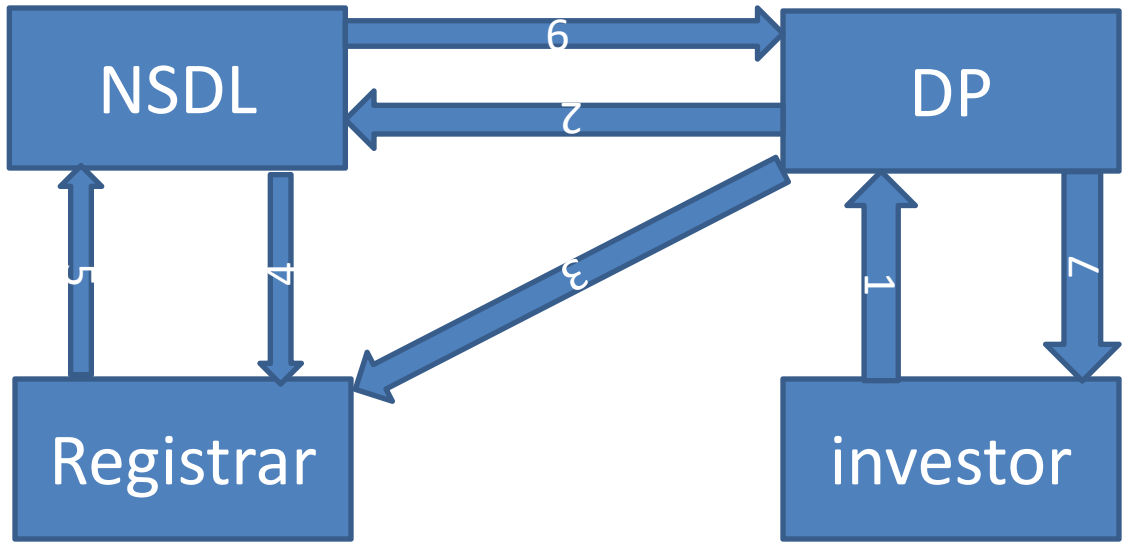
Transaction of the NSDL

- New issues (**brokers**)
- Security market transactions.(**seller**)

Dematerialization :

It is a process in which the physical certificates of an investors are taken back by the company . The registrar destroys the shares & equipment number of shares are credited in the electronic holdings of the investor.

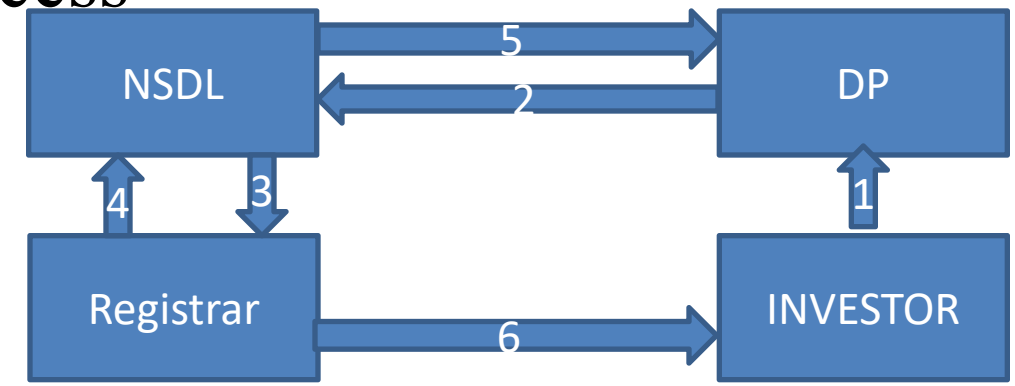
The process :



Rematerialization :

it is a process of converting the electronic holdings back in to physical shares certificate after this process the certificate will bear a new certificate number & new folio number .

The process



Service charges: 0.15% of M.P of the stock per annum + fee + DP-NSDL 0.035; a/c opening charges Rs 1000 + fee. It varies from bank to bank.

Stock Market Indices

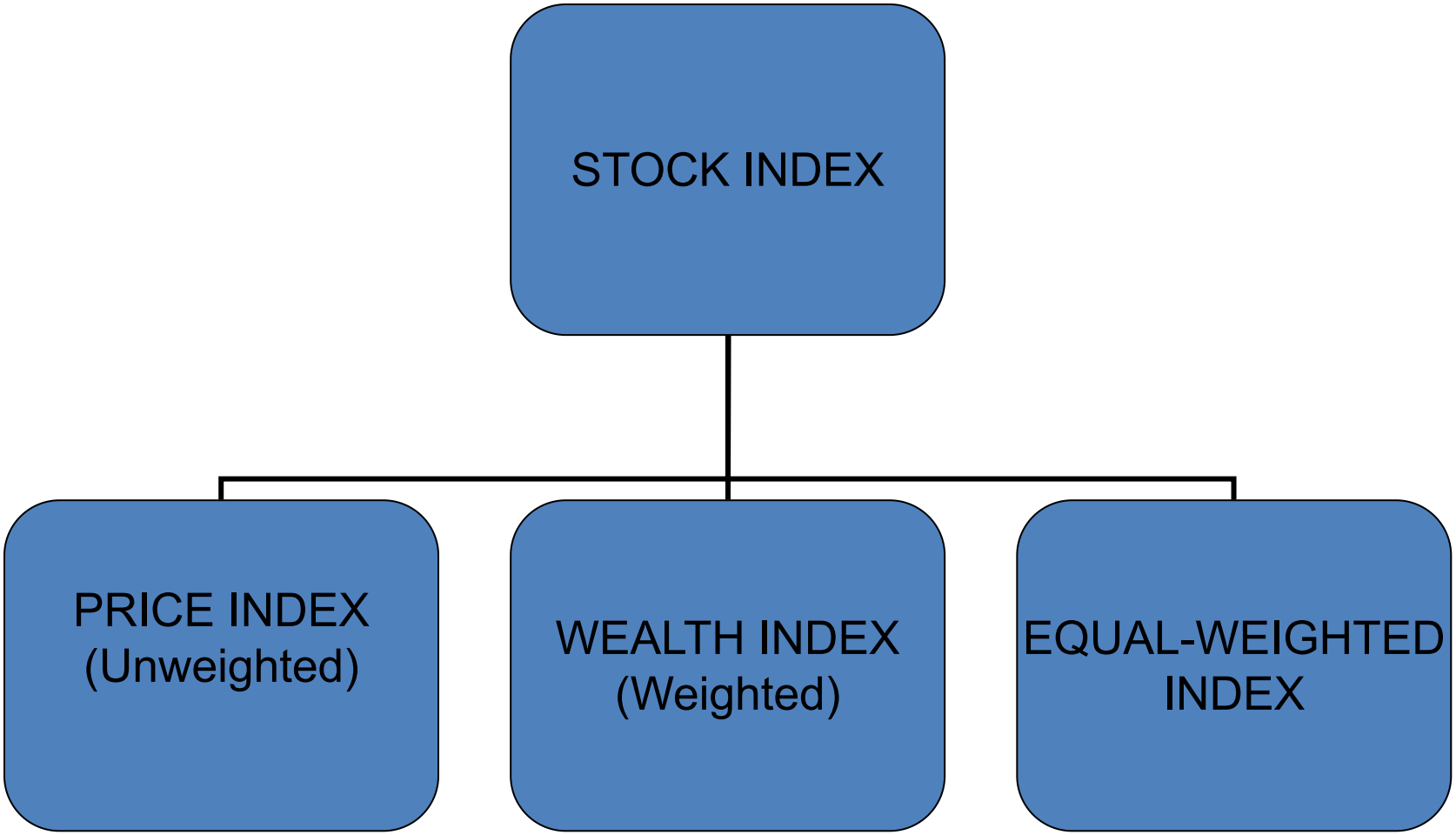
The indices give a broad outline of the market movement and represent the market. Indices are barometer of the stock market.

Eg . BSE-200, dollex, CRISIL , economic times, SENSEX, etc.

Usefulness of Indices

- To recognize the trends in the market.
- Benchmark for evaluating profit.
- Status report of general economy.
- Helps to take decision to allocate funds.
- Index funds and future are formulated with the help of indices.
- To predict the future movements of the market. (technical analyst make use of this).

Computation of stock index



Difference between the indices

- The no of the component stocks-it's a representative sample capable of reflecting market movement sensex-30 scrips, BSE (National)-100, Dollex-200, RBI-338 stocks, Nifty-50 stocks, Crisil-500 etc.
- The composition of the stock- It should reflect the market movement as well as the macro economics changes. It often calls for changing the composition of the index.
- The weights – weighted/ unweighted index.
- Base year- choice of base year leads to variations among the index.

Note: Base year must be free from unnatural fluctuation in the market.

The BSE SENSITIVE INDEX

Barometer of Indian bourses; Base year 1978-79 ; Composition-30 scrips. Criteria adopted in selection of 30 scrips listed.

- Industry representation
- Market capitalization
- The market depth
- Liquidity
- Floating stock depth
- Revision of sensex scrips- The scrips which lose the market interest is dropped and other well performing /market reflecting scrips are added. Now this index has a reproduction of 15 industries.

NSE-50 INDEX (NIFTY)

Built by INDIA INDEX SERVICE LTD(IISL) &CRISIL. The CRISIL has a strategic alliance with standard and poor (S& P) CNX Nifty. NSE-50 was introduced in the year 1996.

Objectives: Reflecting market movements, providing fund managers a tool for measuring profit, basis for introduction of index-derivatives.

Nifty replaced earlier NSE-100 index. The composition of the committee is structured to represent stock exchange, market funds and academicians. This index was revised in the year, Oct 9.

SELECTION CRITERIA :

1. Market capitalisation :- Rs.5 billion or more.
2. Liquidity (Impact cost) :-Cost of executing a transaction in security in property to the weightage of its market. Capitalization as against the index market. At any point of time. It must be not >1.5% for 85% of the traded days.

CNX NIFTY JUNIOR

It consists of 50 stocks belonging to mid- cap companies; having a market capitalizations of > Rs.2 billion. Liquidity criteria is the same as that of standard and poor (S & P) CNX NIFTY- it must be not >2.5 for 85% of the traded days.

- Base year-1995; 'k'-Rs.0.42 trillion.
- Ideal index for derivative trading.

Standard and Poor CNX 500

Consists of 500 scrips, criteria for selection: market ;industry represention, trading interest and financial performance.

Industry groups are 79, Base year-1994

The selected companies should have a minimum record of 3 years of operation with +ve net worth.