UNIT - II

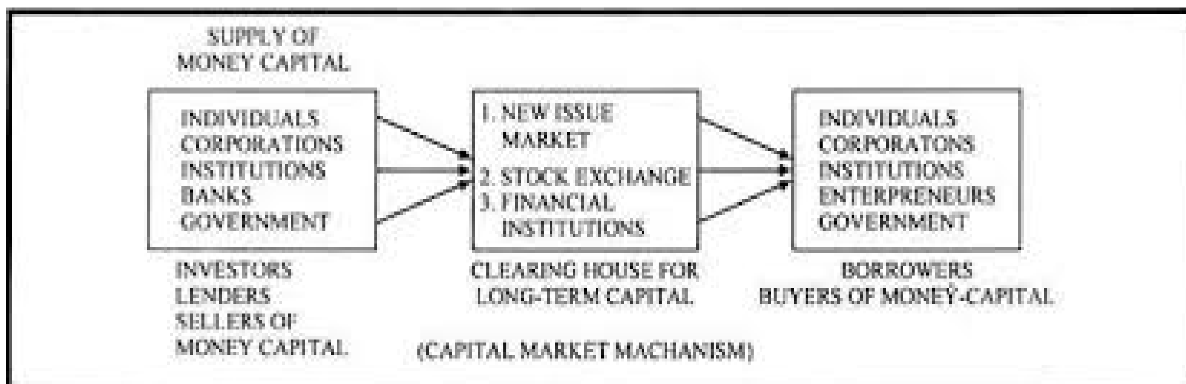
Capital Markets

Objectives

The objectives of this unit are to

- understand the primary and secondary market, different types of issue in primary market and participant in capital market.
- describe listing of securities, settlement of securities transactions.
- highlight the SEBI objectives, functions and role as capital market regulator.
- To understand the modus operandi of depository system.

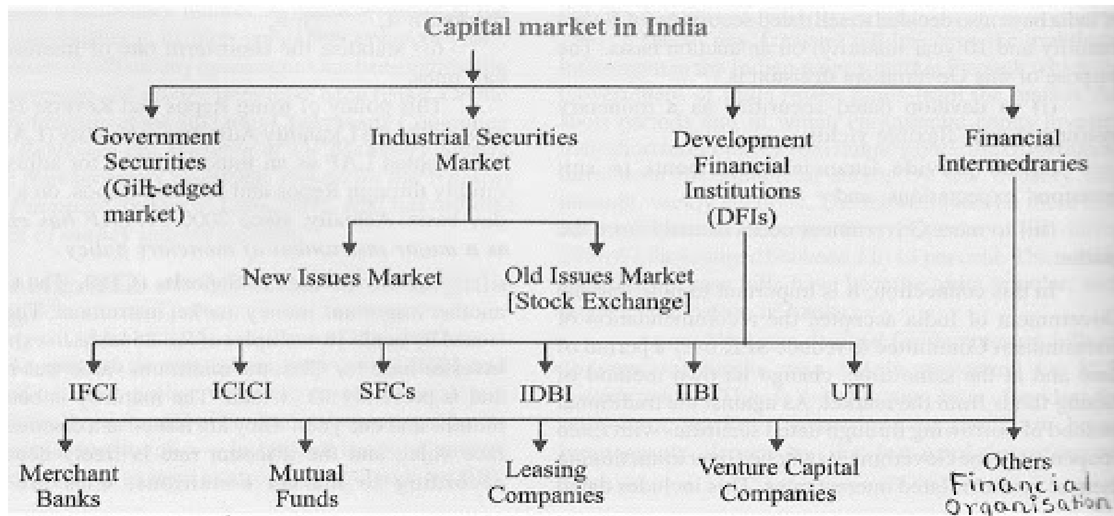
Introduction: Financial markets have a significant role to play in a country's economic development. Financial market channelize the savings from the public (surplus sector) and make it available to(deficit sector) i.e. industry, agriculture and services sector. Financial market has two segments namely: money market and capital market. Money market deals in short term securities while capital market deals in long term securities. Capital market refers to the market or source which helps the corporate in arranging long term finance or long term capital through different capital market instruments like equity shares, preference shares, debentures and bonds. It is the market where securities for more than one year are bought and sold. Since the instruments representing the capital of the company are traded in the market it is called capital market. Capital market facilitates mobilization of resources by corporate and governments. Modern capital market consists of equity and debt segment future and options (F&O) segment. Capital market transactions take place through stock exchanges and it is regulated by Securities Exchange Board of India. The main components of capital market are primary market, secondary/stock market and financial institutions. The mechanism of capital market is described in the following image:



Source: Businessmanagementideas.com/financial market

2.1. Structure of Capital Market

The capital market of India has four main constituents. These are government securities market, industrial securities market, financial institutions and financial intermediaries. The following diagram depicts the structure of Indian capital market:



Source: Kalyan-city.blogspot.com/organizational-structure-of-indian-capital-market

1. **Government Securities Market**: In this segment government and semi government securities backed by Reserve Bank of India are traded. It is called Gilt-edged market too.

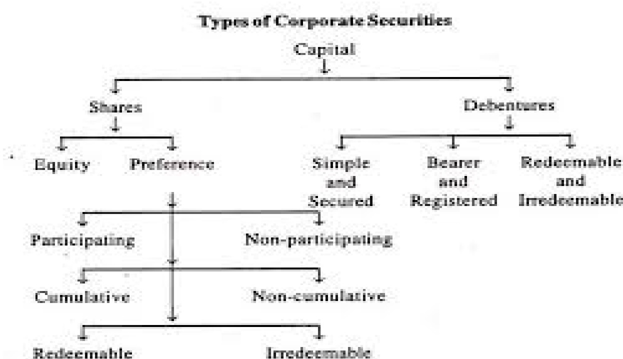
2. **Industrial Securities Market**: In this segment shares and debentures of the existing and new corporate firms of private sectors and public sector are traded. This market is further classified into two segments i.e. primary market secondary. In primary market fresh capital is raised by issuing new shares, bonds/ debentures. In the secondary market securities already issued in primary market are further traded between investors to investors through the registered stock exchanges.

3. **Development Financial Institutions**: This market segment consists of various special purpose financial institutions for example ICICI, SFCs, IDBI, SIDBI, EXIM Bank, UTI, etc. which provide long term finance for particular purpose and sectors of economy for which these are established.

4. **Financial Intermediaries**: Financial Intermediaries like merchant bankers, mutual funds, lease financiers, venture capitalists etc. are organizations act as middlemen to facilitate transfer of funds from surplus sector to deficit sector.

2.2. Capital Market Instruments/Securities

The capital market instruments comprise of equity shares, preference shares, debentures and others hybrid/innovative instruments. There are different type of preference shares and debentures. The diagram reflects the type of corporate securities.



2.3. New Issue/Primary Market

This market consists of all people, institutions, methods, mechanisms, services and practices involved in raising fresh capital for both new and existing companies. It deals in only new securities which are not issued earlier. The task for marketing and selling of securities to public is performed by merchant bankers, investment bankers' underwriters and brokers etc**.**

Functions of Primary Market: Main functions of New Issue Market are:

1. Facilitates transfer of funds from saving public to needy entrepreneurs for productive activities for setting up new companies or expansion/modification/diversification of existing enterprises.
2. Facilitate to sell existing firms to the public as going concerns by converting privately held ownership concerns into public limited companies.

Primary Market performs above functions by providing under mentioned three services:

1. Origination

Origination means deep examination/ scrutiny, analyzing, reviewing, validating and processing of new issue proposals by sponsors of issue. Before forming an opinion to give clearance to the new issue the originator scrutinize the current and proposed activities of the issuing company in terms of legal, environmental, technical, economic and financial aspects. Further they render advisory relating to type of securities be issued, price fixation, timing and size of issue, selling strategies etc.

2. Underwriting

When new issue is not welcomed by public, promoters get shock and all expenses paid to originators prove worthless. To avoid such negative outcome the company appoints underwriter who guarantee that they will buy part of issue not subscribed by market. This type of assurance provider is known as underwriter. Underwriting service is provided on commission basis and guarantees success of the issue.

3. Distribution

Distribution service is provided by dealers, brokers and sub brokers who are constantly direct in touch with present and prospective investors. Sale of securities by distributors to ultimate investors is called distribution.

2.4. Parties involved in the New Issue: The main agencies involved in the public issue are as follows:

- Managers to the Issue (lead manager)
- Registrars to the Issue
- Underwriters
- Bankers
- Advertising agencies
- Financial Institutions and
- Government/Statutory agencies.

2.5. Types of issue

A) Public Issue: It is a method by which companies raise finance by selling shares to investing public in the primary market. Public issue is of three types**:**

1. Initial Public Offerings (IPO): An issue made by a new company in the capital market is called an initial public offering. These issues are listed and traded on stock exchanges as specified in the offer document.

IPO Grading: The basic objective of **IPO** grading is to provide additional fundamentals information to the investors to assess the company offering equity shares or any other security that is convertible into equity shares at later date. IPO grading is given by a Credit Rating Agency like ICRA CRISIL etc. Grades are given on a five point scale. These grades reflect a comparative measurement of fundamentals of issuing company in relation to the other listed companies. The following grades are assigned based on fundamentals of issuing company:

IPO grade 1 - Poor fundamentals

IPO grade 2 - Below-Average fundamentals

IPO grade 3 - Average fundamentals

IPO grade 4 - Above-average fundamentals

IPO grade 5 - Strong fundamentals

2. Follow on Public Offering (FPO): Shares issued by a company already listed on a stock exchange are called a follow on public offer. These are also called follow on public issue.

3. Fast Track Issue (FTI): This facility is available only in BSE and NSE to a well established and compliant listed company in their follow on public offer and right issues. These companies have to provide only rationalize disclosures not comprehensive one for issue of securities.

B) Preferential Issue: When listed companies issue securities to a selected group of persons (financial institutions, mutual funds, high net worth individuals) under section Section 62(1)(c) of Companies Act 2013 it is called preferential issue.

C) Right Issue: If a listed company issues fresh securities to the existing shareholders in the specified ratio to the number of securities already held by them in compliance of the provision of Section 62(1)(a) of Companies Act 2013 it is called right issue of shares

2.6. Types of Investors in New Issue Market

Different categories of investors buy shares in the primary market. They may be retail investors, qualified institutional buyers, employees of issuing company, existing shareholders of the issuing company etc. Basically they are classified into three categories:

Qualified Institutional buyers: Mutual funds, banks, financial institutions, and foreign investors authorised by (SEBI) fall in this category. 50% of the Offer Size is reserved for them.

Non-institutional investors: Resident Indian individuals, HUFs , companies, NRIs, societies, and trust whose application value is more than Rs. 2 lakhs**.** 15% of the Offer is reserved for them.

Retail Investors: They are defined in terms of the value of the primary issue applied by them. This value should not exceed Rs. 2 Lakh**.** 35% of the Offer is reserved for them.

Anchor Investor: An anchor investor is a qualified institutional buyer (QIB) in public issue who applied for a value of ₹10 crores or more through the book-building. Up to 60% of the QIB Category can be allocated to Anchor Investors.

2.7. Methods of New Issue in Primary Market

1. Public Issue through Prospectus: It is the most common method under which the issuing company through a document named as Abridged Prospects invite the public to subscribe its shares at a predetermined price. A prospectus provides all essential information about Issuer Company and purpose of issue, to decide the public to subscribe securities.

Merits

(i) This issue invites a large section of public to invest in the company through advertisement and shares allotted without any discrimination

ii) Sometime it is called direct method as no intermediaries are involved between company and investor.

Demerits

i) This method of issuing of shares is quite costly as it involves huge amount of expenditure like underwriting commission, brokerage, administrative expenses, publicity expenses, legal charges etc.

ii) It is suitable for large issue only.

2. Offer for Sale: Under this method, the company places its securities at an agreed fixed price with some investment banker (firm of brokers/sponsor) who resale these securities to ultimate investors at a higher price. The margin of investment banker/sponsor is called spread which is the difference between selling and buying price.

Merits: This method provide relief to company as it is relieved from printing and advertisement of prospectus and allotment of securities

Demerits: Investment bankers/sponsor sells the securities to investing public at a higher price. The spread earned by them does not become assets of Issuer Company.

3. Private Placement of Securities

This method is similar to offer for sale except the investment banker/sponsor under this method resale the securities at high prices to selected group of individual or institutional investors. The spread is their remuneration for this deal. No need to appoint underwriters as sponsor guarantees hundred percent placement.

Merits:

(a) During phases of recession or depression public do not response through prospects private placement is the suitable choice for new issue of securities.

(b) It suits small companies to raise finance by selling new shares.

Demerits:

(i) As securities are hold by handful of investors, chances of manipulation of market price are increased.

(ii) It down grades image of company in the minds general public.

4. Book Building: "Book Building may be defined as a process used by companies raising capital through Public Offerings-both Initial Public Offers (IPOs) and Follow-on Public Offers (FPOs) to aid price and demand discovery. It is a mechanism where, during the period for which the book for the offer is open, the bids are collected from investors at various prices, which are within the price band specified by the issuer. The process is directed towards both the institutional investors as well as the retail investors. The issue price is determined after the bid closure based on the demand generated in the process**".**

Major Steps in Book Building Process:

1. Issuing company appoint lead merchant banker as 'book runner' and syndicate members
2. Number of shares to be issued and the price band for the bids are decided by issuing company.
3. The syndicate members put the orders placed by investors into an 'electronic book' which stays open for five days. It is just like open auction and is called bidding.
4. Bids are entered within the specified price band and can be changed by the bidders before closing of book.

5. On closing of book building period, book runners assess the bids considering various price levels.
6. Issuing company along with book runners decide the final price at which shares shall be issued.
7. Securities are allocated to the successful bidders and refund is made to rest of the bidders.

Example:

The issuing company doesn't fix up a particular price for the shares, but instead gives a price range/band between Rs. 80 to 100. The lowest price (Rs. 80) is known as the floor price and the highest price (Rs. 100) is known as cap price. "When bidding for the shares, investors have to decide at which price they would like to bid for the shares, e.g., Rs. 80, Rs. 90 or Rs. 100. They can bid for the shares at any price within this range. Based on the demand and supply of the shares, the final price is fixed. The price at which the shares are allotted is known as cut off price. The entire process begins with the selection of the lead manager, an investment banker whose job is to bring the issue to the public. Both the lead manager and the issuing company fix the price range and the issue size. Next, syndicate members are hired to obtain bids from the investors. Normally, the issue is kept open for 5 days. Once the offer period is over, the lead manager and issuing company fix the price at which the shares are sold to the investors.

If the issue price is less than the cap price, the investors who bid at the cap price will get a refund and those who bid at the floor price will end up paying the additional money. For example, if the cut off in the above example is fixed at Rs. 90, those who bid at Rs. 80, will have to pay Rs. 10 per share and those who bid at Rs. 100, will end up getting the refund of Rs. 10 per share. Once each investor pays the actual issue price, the share is allotted."

Source**: http://www.yourarticlelibrary.com/accounting/share/book-building-meaning-process-and-comparison/56798**

5. Employee Stock Option Plan: Employee Stock Option Plan (ESOP) enables employees of a company to buy a fixed number of shares at a predetermined price called exercise price which is lower than existing market price during a specified time period. Sometime a certain part of employee's monthly salary or remuneration is paid in the form of company's securities. This scheme create a sense of belongingness in employees towards company and useful to companies whose business is purely based on the talent of their employees, as in case of IT industry. Statutory compliance is strictly followed while implementing ESOP

2.8. Pricing of New Issues

An issuing company may determine the price of specified securities in consultation with lead manager or through book building process. The coupon rate and conversion price of convertible debt instruments are also determined in the same manner.

SEBI Guidelines for Issue of Fresh Share Capital

1. Company should have the shares issued to the public be listed in one or more recognized stock exchanges.

2. Where the issue of equity share capital involves offer for subscription by the public for the first time, the value of equity capital, subscribed capital privately held by promoters, and their friends shall be not less than 15% of the total issued equity capital.

3. An equity-preference ratio of 3:1 is allowed.

4. Capital cost of the projects should be as per the standard set with a reasonable debt-equity ratio.

5. New company cannot issue shares at a premium".

SEBI Guidelines for First Issue by New Companies in Primary Market:

1. A new company which has not completed 12 months of commercial operations will not be allowed to issue shares at a premium.

2. If an existing company with a 5-year track record of consistent profitability, is promoting a new company, then it is allowed to price its issue"

Source: https://accountlearning.com/sebi-guidelines-fresh-capital-share-primary- secondary mkt.

2.9. Allotment of Shares

"The basis of allotment is decided by lead managers or investment bankers within two weeks of the date of closure in compliance of provisions of Companies Act 2013. As per SEBI guidelines the basis of allotment should be completed within 15 days of the issue closing date. As soon as allotment is completed, with in two working days the details of credit to demat account/allotment advice and despatch of refund order needs to be completed".

2.10. Secondary Market/Stock Exchanges

The secondary market is a market in which existing securities are resold or traded. This market is popularly known as stock market or stock exchange. As per Securities Contract(Regulation) Act, 1956 " Stock exchange is an association, organization or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling, business in buying, selling and dealing in securities." Main stock exchanges of India are Bombay Stock Exchange, National Stock Exchange and Over the Counter Exchange of India.

Functions of Secondary Market

1. Provides platform for continuous trading of securities.

2. Helps in finding price of securities

3. Ensure safe and fair trading

4. Aid in financing the industry

5. Disseminate information

6. Act as barometer of economy

2.11. Stock Market Index

"A stock market index is a statistical measure which shows changes taking place in the stock market. To create an index, a few similar kinds of stocks are chosen from amongst the securities already listed on the exchange and grouped together. The criteria of stock selection could be the type of industry, market capitalization or the size of the company. The value of the stock market index is computed using values of the underlying stocks. Any change taking place in the underlying stock prices impact the overall value of the index. If the prices of most of the underlying securities rise, then the index will rise and vice-versa. In this way, a stock index reflects overall market sentiment and direction of price movements of products in the financial, commodities or any other markets. Some of the notable indices in India are NSE Nifty, BSE Sensex Broad-**based** indices like Nifty 50 and BSE 100, Indices based on market **capitalization** like the BSE Smallcap and BSE Midcap **Sectoral** indices like Nifty FMCG Index and CNX IT."

Source: https://cleartax.in/s/stock-market-index

2.12. Trading at Stock Exchanges

Buying and selling of securities takes place during business hour of specific stock exchange where these are listed. All trading in stock exchanges takes place between 9.55 am and 3.30 pm. Monday to Friday in India. When trading of securities is done beyond business hour it is called kerb trading. An investor cannot buy or sell scrip directly in stock exchange rather it is done through brokers only as per transparent laid down procedure. A brief discussion of trading and settlement procedure of securities in a stock exchange is mentioned below:

1. Opening of Demat Account: All securities are now in electronic format. There are no issues of physical shares/securities anymore. So an investor must open a dematerialized account with the depository participant to hold and trade in such electronic securities. In India there are two depository namely Central Depository Services Ltd. (CDSL) and National Depository Services Ltd. (NDSL).

2. Appointment of Broker: When a person wishes to trade in the stock market, it cannot do so in his/her individual capacity. The transactions can only occur through a broker or a sub-broker. So according to one's requirement, a broker must be appointed. A broker may be an individual/partnership/ company/ bank/financial institution registered under SEBI.

3. Placing Orders: An investor will place an order with his/her broker to buy or sell shares online if the broker provides such services. Important thing to mention here is that the order /instructions should be very clear. Example: Buy 100 shares of XYZ Co. for a price of Rs. 140/- or less. Then the broker will act according to your transactions and place an order for the shares at the price mentioned or an even better price if available. The broker will issue an order confirmation slip to the investor.

4. Execution of the Order: Once the broker receives the order from the investor, he executes it. Within 24 hours of this, the broker must issue a Contract Note. This document contains all the information about the transactions, like the number of shares transacted, the price, date and time of the transaction,

brokerage amount, etc. Contract Note is an important document. In the case of a legal dispute, it is evidence of the transaction. It also contains the Unique Order Code assigned to it by the stock exchange.

5 Settlement: Under this step securities are transferred from the buyer to the seller and the funds transferred from seller to buyer through their demat account. Here too the broker will deal with the transfer. There are two types of settlements.

a) **Spot settlement:** Under this exchange of funds take place immediately and the settlement follows the T+2 patterns. For example a transaction occurring on Monday will be settled by Wednesday (by the second working day)**.**

b) **Forward Settlement:** Under this settlement traders decide to settle the transaction on some future date. It means settlement will take place on some future date. It can be T + 5 or T + 7, etc.

Source: https://www.toppr.com/guides/business-studies/financial-markets/stock-exchange/

2.13. Scrip Traded on Stock Exchanges

"BSE has grouped the stocks into various categories based on trading characteristics such as market capitalisation, trading volumes, numbers, track records, profits, dividends, shareholding patterns, corporate actions and other qualitative aspects. The classification patterns are more or less same in both the main exchanges, BSE and NSE**."**

i. Group A- Specified shares it is among the most liquid stocks and is excellent from all aspects for trading and investing purposes
ii. Group B- Group B, which houses all the stocks that do not fall into any of the above categories. The 'B' counter sees normal volumes and traded are settled under the rolling system. B1 is ranked higher than B2 categories
iii. Group C- Odd lots and permitted shares
iv. Group F- Debt market (Fixed income securities)
v. Group G- Government Securities
vi. Group S' grade companies are small one, typically those with turnovers of Rs 5 crore and tangible assets of Rs 3 crore. They have low liquidity on the bourses. Due to lower volumes, these stocks may also see frenzied price movements
vii. 'Z' category are those which fail to comply with the exchange's listing requirements or may have failed to redress investor complaints

Source : DK Aggarwal, Chairman and MD, SMC Investments and Advisors' Know your Script before Investing' Economic Times Dated 12 Oct.2019

2.14. Compulsory Rolling Settlements: It means crediting funds and debiting securities in the account of seller of securities and crediting securities and debiting funds in the account of buyer of securities or simply clearance of traded securities with in predetermined series of days. The reason behind is to settle the transaction soon after it occurs between buyer and seller of securities, rather than designated day of each month. Most of securities transactions are settled on a rolling basis i.e. (T+1), means next working day after execution of trade.

2.15. Listing of Securities: The scrip trading of a company is possible when it is listed in a specific recognized stock exchange. Prime motive of listing of securities is providing them marketability, liquidity and transferability. A company desirous of listing its securities shall be required to file an application in the prescribed format, with the Exchange in which its securities will be traded by complying legal provisions framed by SEBI and concerned exchange.

Merits of listing

i. General public gets information on daily basis about the price and worth of scrip of a company.
ii. Listing ensures best market price of securities on the basis of market forces.
iii. Listed securities can be traded at any time during business hours of exchange.
iv. Listed companies compulsorily have to publish their financial results on quarterly basis and submit to exchange.
v. Listing provides free transferability of securities.

Listing Criterion: The following are the conditions which must be fulfilled by a company before it goes for listing its securities in the recognized stock exchange

(a) Minimum Issued Capital and Minimum Public Offer*:* The minimum issued capital of the company must be Rs. 3 crore of which at least Rs. 1.80 crore in face value must be offered to the general public.

(b) Minimum number of shareholders*:* There must be at least five public shareholders for every Rs. 1 lakh of fresh public issue of capital and ten public shareholders for every Rs. 1 lakh of offer for sale of the existing capital. The rules are different in case of investment companies.

(c) Payment of interest on excess application money*:* The companies are obliged to pay interest on excess application money at the rates ranging from 4 per cent to 15 per cent depending on the delay beyond 10 weeks from the date of closure of the subscription list.

(d) Listing on more than one exchange and on regional exchanges*:* Every company with paid-up capital of more than Rs. 5 crore has to get itself listed on more than one stock exchange, including compulsory listing on regional stock exchange.

(e) Compulsory provisions in the articles of association*:* A company applying for listing on a recognized stock exchange must satisfy the stock exchange that in addition to other matters, its articles of association provide for the following:

(i) that the company shall use a common form of transfer,

(ii) that the fully paid shares will be free from all lien,

(iii) in the case of partly paid shares, the company's lien, if any, will be restricted to money called or payable at a fixed time in respect of such shares,

(iv) that any amount paid-up in advance of calls on any share may carry interest but shall not entitle the holder of the share to participate in respect thereof, in a dividend subsequently declared,

(v) that there will be no forfeiture of unclaimed dividends before the claim becomes barred by law, and

(vi) that option or right to call of shares shall not be given to any person except with the sanction of the company in general meeting.

2.16. Security Exchange Board of India (SEBI)

With the growth in the dealings of stock markets, a number of malpractices also started in stock markets such as price rigging, an unofficial premium on new issue, delay in delivery of shares, violation of rules and regulations of stock exchange and listing requirements. Due to these malpractices the customers started losing confidence and faith in the stock exchange. So government of India decided to set up an agency or regulatory body known as Securities Exchange Board of India (SEBI) in 1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions. It was left as a watch dog to observe the activities but was found ineffective in regulating and controlling them. As a result in May 1992, SEBI was granted legal status. Since then SEBI is an autonomous/statutory body to balance the twin objectives of investor protection and market development. It has formulated new rules and regulations to foster capital market development. Monitoring and surveillance have been put in place in the stock exchanges and strengthened in the course of time.

Objectives of SEBI: According to the preamble of SEBI its three main objectives are: 1) To protect and promote the interest of the investors in securities 2) To promote the development of the securities market 3) To regulate the securities market

Functions of SEBI: SEBI performs primarily tri functions, namely, protective, developmental and regulatory functions.

1. Protective Functions: These functions are concerned to safety of investment and protecting the interest of investors:

(i) It Checks Price Rigging: Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading: Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices: SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in mid course.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

2. Developmental Functions: SEBI focuses on the following developmental functions to make capital market more vibrant and efficient:

i. SEBI promotes training of participants of capital market to enhance their skills.

ii. SEBI has allowed on line buying and selling of securities through registered stock brokers.

iii. To reduce the cost of issue of securities underwriting is made optional.

(c) Initial public offer of primary market is allowed through stock exchange.

3. Regulatory Functions: Being a regulator of capital market in our country SEBI has framed plethora of guidelines for efficient working of capital market. Some of the major regulatory functions are mentioned below**:**

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

2.17. Role of SEBI

SEBI acts as a watchdog for all the capital market participants and its main purpose is to provide such an environment for the financial market enthusiasts that facilitate efficient and smooth working of the

securities market. To make this happen, it ensures that the three main participants of the financial market are taken care of, i.e. issuers of securities, investor, and financial intermediaries.

Issuers of securities: These are entities in the corporate field that raise funds from various sources in the market. SEBI makes sure that they get a healthy and transparent environment for their needs.

Investor: Investors are the ones who keep the markets active. SEBI is responsible for maintaining an environment that is free from malpractices to restore the confidence of general public who invest their hard earned money in the markets.

Financial Intermediaries: These are the people who act as middlemen between the issuers and investors. They make the financial transactions smooth and safe.

Powers of SEBI

SEBI, being apex authority over capital markets in India is vested with vast powers with regard to the following matters:

(a) SEBI has power to inspect any documents of listed company if it has indulged in prohibited activities (insider trading, fraudulent and unfair trade practices) pertinent to securities.

(b) SEBI has power to grant, renew and cancel registration to practice as stockbrokers, sub brokers, share transfer agents, merchant bankers, underwriters, and others intermediaries participating in capital market.

(c) SEBI has powers of a civil court for trying a suit in respect of matters related to capital market.

(d) It has power to register and regulate the functioning of collective investment schemes and mutual funds.

(e) Board has power to promote investors education and training of intermediaries in the capital market.

(f) Board has power to inspect, audit and order an enquiry of the stock exchanges and capital market participants and intermediaries.

2.18. Capital Market Intermediaries:

Capital market intermediaries are those institutions which act as a middleman in connecting the surplus sector to the deficit sector. Capital market intermediaries ensure the smooth functioning of capital markets through undertaking various roles and responsibilities. Some market intermediaries act in individual capacity while others as organization to bring together surplus sector and deficit sector. Intermediaries of Indian capital market are Brokers, Fund managers, Merchant bankers, Credit rating agencies, Regulatory bodies and Stock depositories and clearing houses

Stock-brokers/Sub-brokers: SEBI regulation define Stock broker as a member of registered stock exchange and a sub-broker as an agent of the stock broker or a person who assists the investors to deal with the stock broker. Registration with SEBI is mandatory for both. Stock brokers are required to maintain book of accounts as stipulated by Board.

Fund/Portfolio Managers: "SEBI regulations define fund manager as any person who pursuant to a contract or agreement with a client, advises or directs or undertakes on behalf of the client, the management or administration of a portfolio of securities or the funds of clients." They construct, evaluate and revise the portfolio of securities on behalf of the client. A fund manager must be registered with Board and shall follow laid down code of conduct. "Every fund manage shall furnish to the SEBI half yearly unaudited financial results when required with a view to monitor the capital adequacy of the portfolio manager."

Credit Rating Agencies: The assessment of the capacity of an issuer of debt securities like debentures/bonds/public deposits by credit agency like (ICRA, CRISIL, CARE etc) to pay interest charges and repayment of debt according to terms and conditions of issue of debt is called credit rating. Debt issuing company is assessed on the basis of its both qualitative and quantitative aspects by rating agency to judge its relative strength and capacity to honor debts obligations as mentioned in debt instrument. Debt issuer rated, is given code numbers by rating agency which are easily understandable by investors. Rating express an opinion to buy, hold or sell security of a company and does not amount to such a recommendation. Further, credit rating being financial advisory service is fee based.

Merchant Bankers: A Merchant bank is an institution which provides a number of services on fee basis including looking after pre-issue and post issue of securities, underwriting, credit syndication, financial advisory, project counseling etc. It is mandatory that all public issues should be managed by merchant banker acting as lead manager. A merchant banker has to follow the guidelines issued by SEBI regarding their qualification, capital adequacy, code of conduct etc.

Underwriters: Underwriters are persons who assured the issuing companies that they will buy the securities in case these are not subscribed by whom to offer. Banks and financial institutions, merchant bankers, members of the stock exchanges, EXIM bank etc act as underwriters. Underwriters do not buy and sell securities rather they stand as back-up supporters. For this assurance they charge fees named as underwriting commission depend upon the nature of securities.

Regulatory Bodies: These are the institutions which control and regulates the buying and selling of securities in capital market in transparent and fair manner by framing rules ®ulations and include SEBI, Specific Stock Exchange, Registrar of Companies, RBI (for FDI and FII).

2.19. Depositories

The word depository means 'a centralized place where securities are kept and recorded in the books on behalf of the investors either in paper or in electric form. Depository can be defined as "An institution which transfers the ownership of securities in electronic mode on behalf of its members" As a consequences of implementation of capital market reforms GOI enacted the Depositories Act in 1996. At present National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited are providers of depository services in India.

Objectives of Depository: A depository enables the capital market to achieve the following objectives:
i) By creating a system for the central handling of securities to reduce time in their transfer,

ii) Avoid the risk of settlement of securities,

iii) Reduce cost of transaction for the investor,

iv) Enhance liquidity and efficiency,

v) Promote the country's competitiveness by complying with global standard.

Constituents of Depository System: There are four players in the depository system namely depository participant, investor, issuer and depository.

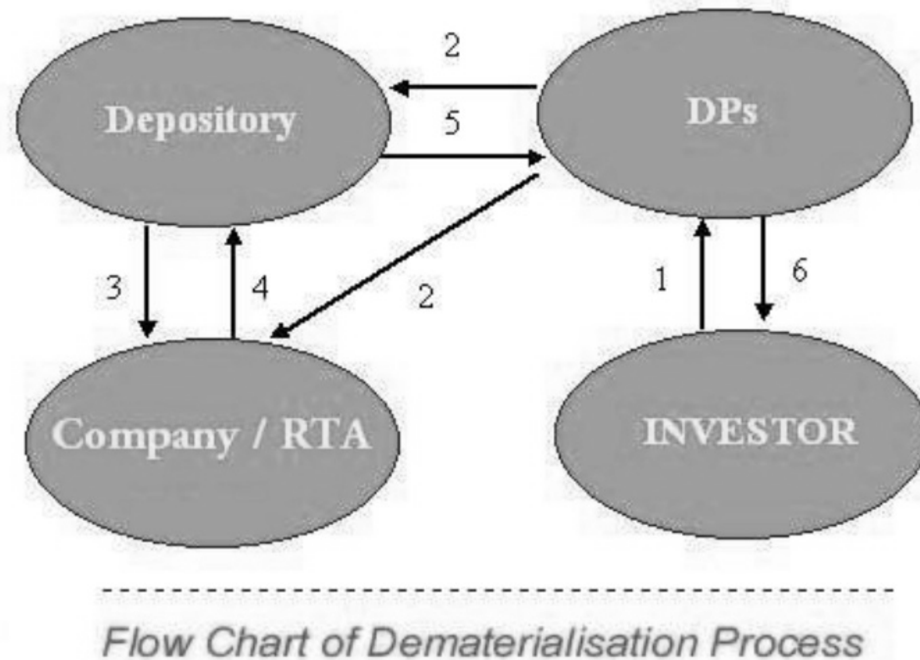
Depository Participant: A DP, generally a bank is an agent of depository. An investor who buys or sells securities and wants to avail depository services he has to open D Mat. Account with DP. It is just like to open any other account in a bank. A D Mat. Account keeps the record of securities of investor. A DP must be registered with SEBI and it could be a bank financial institution clearing corporation etc. List of DPs can be seen on specified depository portal.

Investor/Beneficial owner: Investor/ beneficial owner is the real owner of the securities who has lodged his scrip with the depository in the form of book entry.

Issuer: An issuer is a company that issues securities and maintains record of registered owners of scrip with depositories. As per SEBI rule every issuer whose scrip have been declared as eligible to be held in dematerialization form in a depository, shall enter into an agreement with depository and shall maintain a record of certificates of securities which have been dematerialized.

Depository: A depository (NSDL, CDSL) is a firm wherein the scrips of an investor are held in electronic form in the same way a bank holds money of its depositor. It carries out the transactions of securities by means of book entry without physical movement of securities. Depository acts as a defecto owner of scrips lodged with it for the limited purpose of transfer of ownership. All capital market and money market securities, units of mutual funds and collective investment schemes are eligible to be kept in demat form with depositories.

Clearing and Settlement Corporation: "It is a center to do trade matching and settle the funds and exchange securities/ settles the transfer of funds between the buyer and seller of securities".



Flow Chart of Dematerialisation Process

Source:https://www.google.com/search?q=depository++chart&tbm=isch&hl=en&chips=q:depository++chart,online_chips:dematerialisation&hl=en&ved=2ahUKEwjwzbKh47roAhWikeYKHSWxAncQ

Procedure in the Depository system

"When the shares are handed over to the **depository system**, the shares get immobilized as they are no more with the shareholder in physical form. The stock exchange concerned where the shares are listed will come out with a notification for the dematerialization of shares. The shareholder will obtain the dematerialization request form from the Depository Participant. This form will contain details about the name of the company, folio number and the distinctive number of the shares which are given for dematerialization. The form will be signed by either the single owner if it is held so or by joint owners, when they are held jointly. When the DP hands over the securities to the depository, the securities will be sent to Share Registrar who will register the depository name and the particulars of shares. But, before doing this, the ownership of the securities should be verified with the company and hence, this procedure will take some time. In case the signature in the requisition form does not tally with the specimen signature held by the company, then the request for dematerialization will be rejected as it amounts to bad delivery. In the last stage, the Depository will inform the DP the details of shares registered in the name of the shareholder concerned. On this basis, the DP will send the Statement of Account to the customer shareholder".

Self Assessment Questions

1. Discuss the relationship between primary market and secondary market.
2. Explain the various methods of floating of new issue.
3. Describe the different types of investors in the primary market.
4. Write in brief about the various participant of capital market?
5. Describe the functions and role of SEBI.
6. Highlight the modus operandi of 'depository system '
7. Write notes on: Book Building, Listing of securities, Merchant Bankers, Initial Public Offer, Pricing of new issue

Suggested Book Readings:

1. Security Analysis and Portfolio Management:- By Punithavathy Pandian. Vikas Publishing House PVT. LTD.

2. Security Analysis and Portfolio Management:- By S Sasidharan and Alex K Mathews. Tata McGraw Hill Education Private Limited.

3. Security Analysis and Portfolio Management:- By S Kelvin. PHI Learning Private Limited.

4. Security Analysis and Portfolio Management:- By Donald E Fisher, Ronlad J Jordon and A K Pradhan. Pearson IN.