

CHAPTER – 1.**AN INTRODUCTION TO CAPITAL MARKET**

1. INTRODUCTION

To earn wealth is natural phenomena of every person for his future necessity side by side it should help the growth of country's economy. As much as skills are required to earn money, it is required in equal measure in spending it wisely. Proper financial knowledge can improve person's ability to save for his long term goals and prevent himself and his family from financial exigencies. Generally, savings is in the form of savings bank account and in cash. It is very safe in savings account, earning a small rate of interest and gets back money as and when need it (high liquidity). However, prudent investments can earn a lot more than in savings account.

There are various Investment Related Products in market as (i) fixed deposit scheme offered by (manufacturing) companies. They are similar to bank fixed deposits but entail lesser liquidity and usually carry higher risk and return. (ii) Capital market offers products like equity, debt, hybrid instruments and various mutual fund schemes. Each of this investment class carries different risk-return profile and is covered separately under 'products available in capital markets'. As a shareholder, a person is part owner of the company and entitled to all the benefits of ownership, including dividend (company's profit distributed to owners). Debentures or bonds are debt instruments which pay interest over their life time and are used by corporate to raise medium or long term debt capital. If one has constraints like time, wherewithal, small amount etc. to invest in the market directly, Mutual Funds (MFs), which are regulated entities, provide an alternative avenue. They collect money from many investors and invest the aggregate amount in the markets in a professional and transparent manner. The returns from these investments net of management fees are available to you as a MF unit holder. However, there should be statutory regulatory measures for investors and shareholder, which can protect them from fraud and other malpractices as they may not be expert in securities market. Before going in details of regulatory measures taken by government

since nineteenth century, let's have a look on the origin of joint stock companies, an overview of financial system and the concept of capital market.

2. ORIGIN OF JOINT STOCK COMPANIES

The joint stock companies had its origin in the middle of 19th Century, enabling the pooling of small savings from the general public into the companies' treasury and issuing shares to the investors in lieu thereof. Initially the benefit of limited liability did not attach to these corporate securities called company shares. In other words, investments in companies carried the same unlimited liability for the investors as was the case with investments in proprietorship concerns and partnership firms. The investors control the management group through their representatives at the Board meetings and other company meetings, where the affairs of the company are managed by professionals. Thus, the privity and close association which are noticed in a partnership firm amongst the investing partners do not exist in a joint stock company between the management and the investing public. Soon after the concept of joint stock companies came into being a number of companies mismanaged and lost their capital and worse still, the creditors chased the investors of the joint stock companies and attached their private properties also, to satisfy their claims on the basis of unlimited liability. At this juncture, the joint stock concept itself received a rude shock and was about to become defunct. First at this stage that the protection of limited liability was conceived and added as a feature of the investments in the shares of joint stock companies. In fact, this innovation was a remarkable one which paved the way for large sized joint stock companies to emerge and mop up private savings for being channelised into productive purposes. It is therefore often held that after the invention of the Rail Road Engine, the most spectacular innovation of the 19th Century was the creation of joint stock companies with limited liability for the investors and with separation of ownership from management in the conduct of trade and commerce.

With the growth in corporate activity collection of funds towards shares in joint stock companies became common. However this involved detailed legal provisions in different enactments compelling issuers of capital to disclose all relevant information fully and fairly and to follow the laid down procedures

for protecting the interest of investors, and consulting and obtaining approval from them on matters of relevance to them. The practice of circulating annual accounts prepared by the Board of Directors, to the members along with the director's report and seeking their approval for appointment of directors and auditors and obtaining their consent on other statutorily prescribed matters had its origin from the above considerations. The principle of corporate democracy was embedded in the corporate legislations from the Inception so that the managements even while possessing majority voting power in their hands were obliged to consult and give an opportunity to the minority share holders also, to have a say in passing resolutions at the general meetings. The system of statutory audit by duly qualified accountants holding certificate of practice and observing standard accounting procedure and disclosure norms followed in due course.

3. CONCEPT OF CAPITAL MARKET

The capital market is a market for financial investments that are direct or indirect claims to capital¹. The capital market comprises the complex of institutions and mechanism through which intermediate term funds and long term funds are pooled and made available to business, government and individuals.

The capital Market also encompasses the process by which securities already outstanding are transferred². The capital market is a place where the suppliers and users of capital meet to share one another's views, and where a balance is sought to be achieved among diverse market participants. The securities decouple individual's acts of saving and investment over time, space and entities and thus allow savings to occur without concomitant investment.

Moreover, yield- bearing securities makes present consumption more expensive relative to future consumption, including people to save. The composition of savings changes with less of it being held in the form of idle

¹ Gart A; Handbook of the money and capital market quorum Books New York 1988

² Dougall, He and Jace E. Gauminitz; capital market and institutions, prentice Hall, new jersey, 1986

money or unproductive assets, primarily because more divisible and liquid assets are available³.

The Capital market facilitates mobilization of savings of individuals and pools them into reservoir of capital which can be used for the economic development of a country. An efficient capital market is essential for raising capital by the corporate sector of the economy and for the protection of the interest of investors in corporate securities. There arises a need to strike a balance between raising of capital for economic development on one side and protection of investors on the other. Unless the interests of investors are protected, raising of capital, by corporates is not possible. An efficient capital market can provide a mechanism for raising capital and also by protecting investors in corporate securities⁴.

The capital market has two interdependent and inseparable segments, the primary market and stock (secondary market).

3.1 Primary Market

The primary market provides the channel for sale of new securities. The issuer of securities sells the securities in the primary market to raise funds for investment and/ or to discharge. In other words, the market wherein resources are mobilised by companies through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, modernisation, diversification and upgradation.

The issue of securities by companies can take place in any of the following methods:-

- a. Initial public offer (securities issued for the first time to the public by the company);
- b. Further issue of capital;
- c. Rights issue to the existing shareholder (on their renunciation, the shares can be sold by the company to others also);

³ Developments of Capital Market In India At London School Of Economics On 2nd October, 2006. By G N Bajpai

⁴ Vashisht and Gupta 2005

d. Offer of securities under reservation/ firm allotment basis to;

- (i) foreign partners and collaborators,
- (ii) mutual funds
- (iii) merchant bankers
- (iv) banks and institutions
- (v) non resident Indians and overseas corporate bodies
- (vi) Employees.

e. Offer to public

f. Bonus Issue.

The primary market is of great significance to the economy of a country. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of a country is gauged by the activities of the Stock exchanges. The primary market creates and offers the merchandise for the Secondary Market.

3.2 Secondary Market

Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets.

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The secondary market has further two components, namely the over-the-counter (OTC) market and the exchange- traded market. OTC is different from the market place provided by the Over The Counter Exchange of India Limited. OTC markets are essentially informal markets where trades are negotiated. Most of the trades in government securities are in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not provide facility for spot trades in a strict sense. Closest to spot market is the cash market where settlement takes place after some time. Trades taking place over a trading cycle, i.e. a day under rolling

settlement, are settled together after a certain time⁵. Trades executed on the leading exchange are cleared and settled by a clearing corporation which provides novation and settlement guarantee.

A variant of secondary market is the forward market, where securities are traded for future delivery and payment. Pure forward is outside the formal market. The versions of forward in formal market are futures and options. In futures market, standardised securities are traded for future delivery and settlement. These futures can be on a basket of securities like an index or an individual security. In case of options, securities are traded for conditional future delivery. There are two types of options—a put option permits the owner to sell a security to the writer of options at a predetermined price while a call option permits the owner to purchase a security from the writer of the option at a predetermined price. These options can also be on individual stocks or basket of stocks like index. Two exchanges, namely NSE and the Bombay Stock Exchange, (BSE) provide trading of derivatives of securities.

4. PRODUCTS & PARTICIPANTS OF CAPITAL MARKET⁶

Transfer of resources from those with idle resources to others who have a productive need for them is perhaps most efficiently achieved through the securities markets. Stated formally, securities markets provide channels for reallocation of savings to investments and entrepreneurship and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's abilities to invest and save respectively, which inevitably enhances savings and investment in the economy.

Savings are linked to investments by a variety of intermediaries through a range of complex financial products called “securities” which is defined⁷ in the Securities Contracts (Regulation) Act, 1956 to include:

- 1) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or body corporate;

⁵ Currently 2 working days

⁶ Manual of NSE- NCFM

⁷ Section 2(h) of the Securities Contracts (Regulation) Act, 1956

- 2) derivatives;
- 3) units of any other instrument issued by any collective investment scheme to the investors in such schemes;
- 4) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
- 5) units or any other such instrument issued to the investors under any mutual fund scheme;
- 6) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be;
- 7) government securities,
- 8) Such other instruments as may be declared by the Central Government to be securities; and rights or interest in securities.

There are a set of economic units who demand securities in lieu of funds and others who supply securities for funds. These demand for and supply of securities and funds determine, under competitive market conditions in both goods and securities market, the prices of securities which reflect the present value of future prospects of the issuer, adjusted for risks and also prices of funds.

It is not that the users and suppliers of funds meet each other and exchange funds for securities. It is difficult to accomplish such double coincidence of wants. The amount of funds supplied by the supplier may not be the amount needed by the user. Similarly, the risk, liquidity and maturity characteristics of the securities issued by the issuer may not match preference of the supplier. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match and bring the suppliers and users of funds together. These intermediaries may act as agents to match the needs of users and suppliers of funds for a commission, help suppliers and users in creation and sale of securities for a fee or buy the securities issued by users and in turn, sell their own securities to suppliers to book profit. It is, thus,

a misnomer that securities market disintermediates by establishing a direct relationship between the savers and the users of funds.

The securities market, thus, has essentially three categories of participants, namely the issuers of securities, investors in securities and the intermediaries. The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers (they subscribe for and trade in securities) of securities issued by issuers. In pursuit of providing a product to meet the needs of each investor and issuer, the intermediaries churn out more and more complicated products. They educate and guide them in their dealings and bring them together. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and by custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of suppliers of funds. The regulator ensures a high standard of service from intermediaries and supply of quality securities and non-manipulated demand for them in the market.

5. CAPITAL MARKET INSTRUMENTS

Classification of Instruments can be classified into three categories: 1. pure, 2. Hybrid, and 3. Derivatives.

5.1 Pure instruments: Pure instruments can be classified into Equity Shares, preference shares and debentures/ bonds which were issued with their basic characteristics in tact without mixing features of other classes of instruments are called Pure instruments.

5.1.1 Equity shares- equity shares commonly referred to as ordinary share also represents the form of fractional ownership in which a shareholder, as a fractional owner, undertake the maximum entrepreneurial risk associated with business a business venture. The holder of such shares is member of the company and has voting rights. A company may issue shares with differential rights as to voting, payment of dividend etc.

5.1.2 Preference shares- Owners of this kind of shares are entitled to a fixed dividend or dividend calculated at a fixed rate to be paid regularly before dividend can be paid in respect of equity shares. They also enjoyed priority over the equity shareholders in payment of surplus. But in the event of liquidation their claims rank below the claims of company's creditors, bondholders/ debenture holders. Following kinds of preference shares are dealt with by the companies-

5.1.2.(a). Cumulative preference shares- In the case of this type of share the dividend payable every year becomes a first claim while declaring dividend by the company. In case the company does not want to pay preference dividend, it gets accumulated for being paid subsequently.

5.1.2.(b). Non cumulative preference shares- In the case of these shares, dividend does not accumulate. If there are no profits or the profits are inadequate in any year, the shares are not entitled to any dividend for that year. Unless there is a specific provision in the Articles of Association of the company.

5.1.2.(c). Convertible preference share- If the term of issue of preference shares includes a right for converting them into equity shares at the end of a specified period they are called convertible preference shares.

5.1.2.(d). Redeemable preference shares- If the articles of a company so authorize, redeemable preference shares can be issued. This in contrast to the principle that the company normally can not redeem or buy back its own shares vide section 77 of the companies act, 1956, except by following the procedure for reduction of capital and getting the sanction of the high court in pursuance of sections 100 to 104 or section 402 of the companies act.

5.1.2.(e). Irredeemable preference shares- If the terms of issue provide that the preference shares are not redeemable except on the happening of

certain specified events which may not happen for an indefinite period such as winding up, these are called irredeemable preference shares.

5.1.2.(f). Participating preference shares- Preference shareholders are not entitled to dividend more than what has been indicated as part of the terms of issue, even in a year in which the company has made huge profits. Subject to provision in the terms of issue these shares can be entitled to participate in the surplus profits left, after payment of dividend to the preference and the equity shareholders to the extent provided therein.

5.1.2.(g). Non participating preference shares- Unless the terms of issue indicate specifically otherwise, all preference shares are to be regarded as non participating preference shares.

5.1.3 Debentures⁸- Debenture includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. Debenture is a document evidencing a debt or acknowledging it. Debentures are issued in the following forms:-

5.1.3.(a) Naked or unsecured debentures – Debentures of this kind do not carry any charge on the assets of the company.

5.1.3.(b). Secured Debentures- Debentures that are secured by a mortgage of the whole or part of the assets of the company are called mortgage debentures or secured debentures.

5.1.3.(c). Redeemable Debentures- Debentures that are redeemable on expiry of certain period are called redeemable debentures. Such debentures after redemption can be reissued in accordance with the provisions of section 121 of the Companies Act 1956.

⁸ Section 2 (12) of the Companies Act, 1956

5.1.3.(d). Perpetual Debentures- If the debentures are issued subject to redemption on the happening of specified events which may not happen or an indefinite period, i.e. winding up, they are called perpetual debentures.

5.1.3.(e).Bearer Debentures – Such debentures are payable to bearer and are transferable by mere delivery. The name of the debenture holder is not registered the books of the company, but the holder is entitled to claim interest and principal as and when due.

5.1.3.(f). Registered debentures- Such debentures are payable to the registered holders whose name appears on the debentures certificate / letter of allotment and is registered on the companies register of debenture holder maintained as per section 152 of the Companies Act, 1956.

Based on convertibility, debentures can be classified under three categories-

5.1.3.(g). Fully convertible debentures (FCDs)- These are converted into equity shares of the company with or without premium as per terms of the issue on the expiry of specified period or periods.

5.1.3.(h).Non Convertible Debentures (NCDs) – These debentures do not carry the option of conversion into equity shares and are therefore redeemed on the expiry of the specified period or periods.

5.1.3.(i) Partly Convertible Debentures (PCDs)- These may consist of two kinds namely- convertible and non convertible. The convertible portion is to be converted into equity shares at the expiry of specified period.

5.2 Hybrid Instruments- Hybrid instruments are those which are created by combining the features of equity with bond, preference and equity etc. Examples of hybrid instruments are : Convertible Preference shares,

Cumulative convertible preference shares, non convertible debentures with equity warrants, partly convertible debentures, partly convertible with Khokha (buy back arrangement) , optionally convertible debenture, warrants convertible into debentures or shares, secured premium notes with warrants etc.

5.2.1. Secured premium notes- These instruments are issued with detachable warrants and are redeemable after a notified period say 4 to 7 years. The warrants enable the holder to get equity shares allotted provided the secured premium notes are fully paid. During the lock in period no interest is paid. The holder has an option to sell back the SPN to the company at par value after the lock in period.

5.2.2. Equity shares with Detachable Warrants- Essar Gujarat, Ranbaxy and Reliance issued this type of instrument. The holder of the warrant is eligible to apply for the specified number of shares on the appointed date at the predetermined price. These warrants are separately registered with the stock exchanges and traded separately. The practice of issuing non convertible debentures with detachable warrants also exists in the Indian market. Reliance has used this method.

5.2.3 Deep Discount bond- IDBI and SIDBI had issued this type of instrument. For a deep discount price of Rs. 2700/- in IDBI the investor got a bond with face value of Rs. 100000/-. The bond appreciates to its face value over the maturity period of 25 years. Alternatively, the investor can withdraw from the investment periodically after 5 years.

5.2.4 Tracking Stocks – Dr. JJ Irani Expert Committee constituted by the Government to make recommendation on the Concept Paper on Company Law has recommended in its report for the introduction of ‘Tracking Stocks’ in the Indian Capital Market. A Tracking stock is a type of common stock that “tracks” or depends on the financial performance of a specific business unit or operating division of a company, rather than the operations of the company as a whole. As a result, if the unit or division

performs well, the value of the tracking stocks may increase, even if the company's performance as a whole is not up to mark or satisfactory. The opposite may also be true.

5.2.5 BONDS- Following kinds of bonds may be issued:-

(a) Disaster Bonds- These are issued by companies and institutions to share the risk and expand the capital to link investors return with the size of insurer losses. The bigger the losses, the smaller the return and vice versa. The coupon rate and the principal of the bonds are decided by the occurrence of the casualty of disaster and by the possibility of borrower defaults.

(b) Option bonds- This instrument covers those cumulative and non cumulative bonds where interest is payable on maturity or periodically and redemption premium is offered to attract investors.

(c) Easy Exit Bonds- This instrument covers both bonds which provide liquidity and an easy exit route to the investor by way of redemption or buy back where investors can get ready encashment in case of need to withdraw before maturity.

(d) Pay in Kind Bonds- This refers to bonds wherein interest for the first time three to five years is paid through issue of additional bonds, which are called baby bonds as they are derived from parent bond.

(e) Split Coupon Debentures- This instrument is issued at a discounted price and interest accrues in the first two years for subsequent payment in cash. This instrument helps better management of cash outflows in a new project depending upon cash generating capacity.

Other bonds like floating rate bonds and notes, clip and strip bonds, Dual convertible Bonds, Debt Instruments with Debt warrants, Indexed Rate Notes, Stepped coupon Bonds, Dual Option Warrants, Extendable notes, Level pay floating rate notes, Industrial Revenue Bonds, Commodity

bonds, Zero Coupon Convertible Notes, Foreign Currency Convertible Bonds (FCCBs), are issued by the companies.

5.3 Derivatives- Future and option belong to the categories of derivatives.

Derivatives- Derivatives are contracts which derive their value from the value of one or more of others assets. Some of the most commonly traded derivatives are futures, forward, options and swaps.

5.4 New schemes of Funds-

5.4.1. Hedge Fund⁹-Hedge funds including fund of funds are unregistered private investment partnership, funds or pools that may invest and trade in many different markets, strategies and instruments (including securities, non securities and derivatives) and are not subject to the same regulatory requirements as mutual funds, including mutual fund requirements to provide certain periodic and standardized pricing and valuation information to investors. Hedge funds are sometime called as rich man's mutual funds.

5.4.2 Gold Exchange Trade funds- SEBI (Mutual Funds) Amendment Regulations dated January 24, 2006 permitted introduction of Gold Exchange Traded Fund schemes by Mutual Fund. Gold Exchange Traded Fund (GETF) schemes are permitted to invest primarily in Gold and Gold related instruments i.e. such instruments having gold as underlying as are specified by SEBI from time to time.

The above list of Capital Market is not exhaustive but inclusive. Other instruments may be created with the approval of capital market regulator depending upon the requirement of the economy and industry. The instruments used by the corporate sector to raise funds are selected on the basis of – (i) investor preference for a given instrument and (ii) the regulatory framework, whereunder the company has to issue the security.

⁹ Excerpts from SEBI report on “policy options permitting foreign hedge to access Indian Securities Market”. The report was released by SEBI for public comments on 24.05.2004)

The corporate sector and financial / investment institutions has been issuing new instruments to attract investors. The attraction for the instrument for both the corporate sector and the investor lies in – (a) the investor gets a reasonable return during the initial years, followed by equity participation on conversion, and (b) the issue involves lower post tax cost of capital, thereby entailing a lesser strain on liquidity.

6. INVESTORS' INTERESTS, RIGHTS AN GRIEVANCES

6.1 WHO IS AN INVESTOR¹⁰:- An investor is a person who is an individual or a corporate legal entity investing his capital in another venture or business but does not do the business himself or itself. The investor has no role to play in the day-to-day management of the business or its control except as permitted by the law. Investor carries on business when they buy and sell assets, arranges for other to buy and sell assets, manages assets belonging to others, or operates collective investment schemes.

These activities are engaged by an investor, but they are not having any control over the day to day activities of any corporate. Normally, an investor is a blind person; they do not know any activities made by the company. Investor cannot guide the fate or destiny of the money invested. An investor to that extent is quite fragile and is exposed to certain risks because the utiliser of his money can commit mistakes. Normally they are contributing the funds for productive purpose of the company, and they are exposing him to the business decisions that the company has taken or will be taking.

There are no doubt laws some of which are adequate but some are not. An investor obviously needs some protection per se¹¹

Investors are a heterogeneous group, they may be large or small, rich or poor, expert or lay man and not all investors need equal degree of protection¹². An investor has three objectives while investing his money, namely safety of invested money, liquidity position of invested money and return on investment.

¹⁰ Vashisht, A K Gupta and R K (2005) "Investment Management and Stock Market : Strategies for Successful Investing" Deep & Deep Publications Pvt Ltd. New Delhi, I Edition p.5, 10.

¹¹ Vashisht, A K Gupta and R K (2005) "Investment Management and Stock Market : Strategies for Successful Investing" Deep & Deep Publications Pvt Ltd. New Delhi, I Edition p.5, 10.

¹² Mayya MR 1996 "Investor Protection" Bharat Law House Pvt Ltd. New Delhi I Edition , p.

The return on investment may further be divided into capital gain and the rate of return on investment as interest or dividend. Among all investment options available as shown in Figure 1.1 securities are considered the most challenging as well as rewarding.

6.2 TYPES OF INVESTORS:-

6.2.1 Qualified institutional Bidders.

QIB's are the following entities as defined in the SEBI ICDR Regulations:

1. A mutual fund, venture capital fund and foreign venture capital investor registered with the board;
2. A foreign institutional investor and sub account (other than a sub account which is a foreign corporate or foreign individual), registered with SEBI;
3. A public financial institution as defined in section 4 A of the companies Act,1956
4. A scheduled commercial bank;
5. A multinational and bilateral development financial institution
6. A state industrial development corporation;
7. An insurance company registered with the Insurance Regulatory and Development Authority;
8. A provident fund with minimum corpus of Rs. 25 crore;
9. A pension fund with minimum corpus of Rs. 25 crore;
10. National Investment Fund¹³;
11. Insurance fund set up and managed by army, navy or air force of the Union of India.

6.2.2 Retail Individual Bidders

Individual investor and HUF firms who apply for allotment of shares with bid amount not more than Rs. 100,000/- come under this category. A minimum of 35% of net issue size is reserved for allotment to this category. If the issue is under Rule 19(2)(b) of the SC (R) R whereby 60% of the issue size is reserved for QIB, it is mandatory to offer 30% of the shares to retail individual investors.

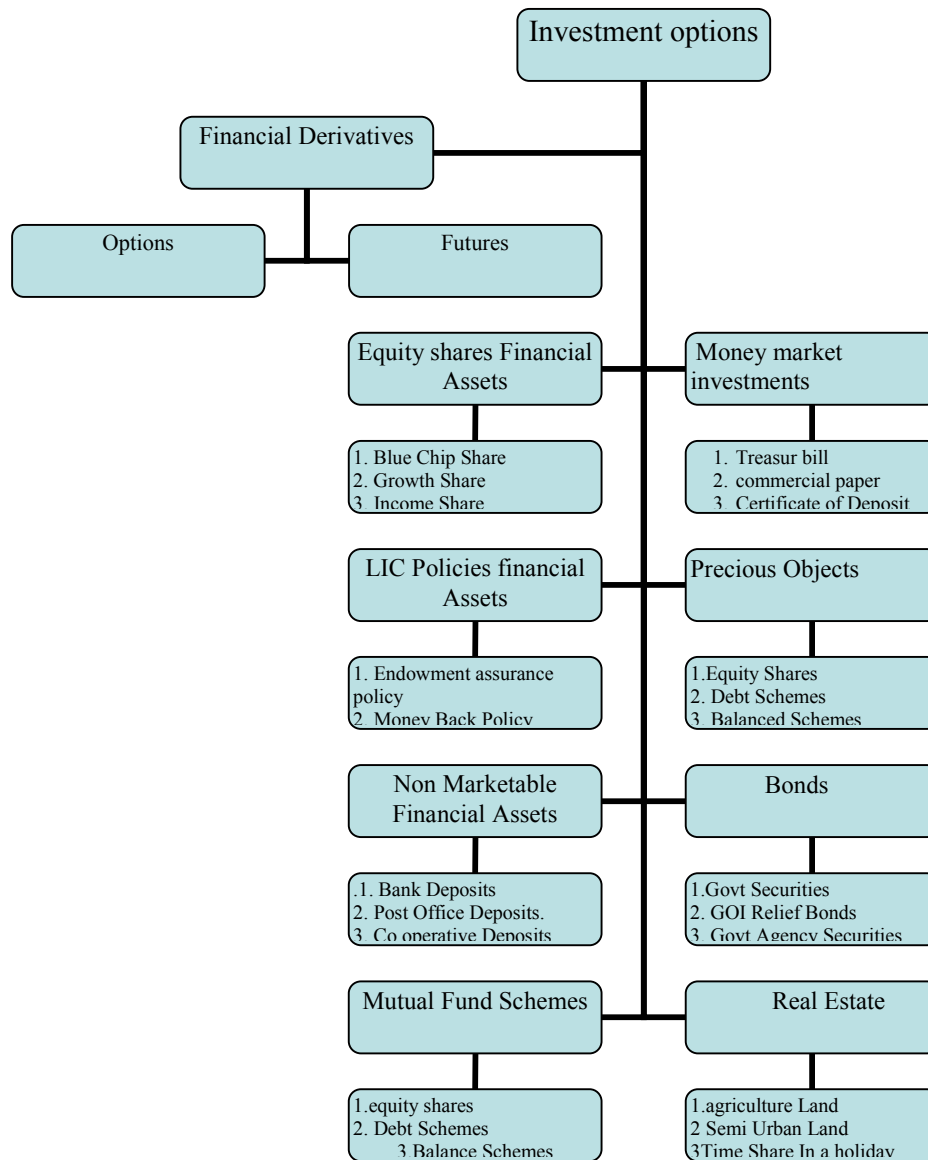
¹³ set up by resolution No. F. No. 2/3/2005- DDII, dated November 23, 2005 of the Government of India published the Gazette of India

6.2.3. Non Institutional Bidders

Bids for value exceeding Rs. 100000/- from individual/ HUF investors, bodies corporate, trusts (registered under the societies Act) and other eligible investors who do not come under the category of QIB are eligible to invest in shares of the issuing entity are considered under this category. 15% or 10% (where 60% of the issue is earmarked for QIBs) of the issue is earmarked to non institutional bidders.

6.3 INVESTMENT OPTIONS AND RISK-RETURN ANALYSIS

An investor has three objectives while investing his money, namely safety of invested money, liquidity position of invested money and return on investment. The return on investment may further be divided into capital gain and the rate of return on investment as interest or dividend. Among all investment options available as shown in Figure 1.1 securities are considered the most challenging as well as rewarding. Securities include shares, debentures, derivatives, units of mutual funds, Government securities etc. An investor may be an individual or corporate legal entity investing funds with a view to derive maximum economic advantage from investment such as rate of return, capital appreciation, marketability, tax advantage and convenience of investment.

Figure 1.1¹⁴ : Investment Avenues

Different securities carry different risk-return profiles. Generally, higher risks carry higher returns and vice-versa. The risks may be taking the form of credit risk [counter party may default payment as it may not have integrity]. The return risk [the return from the investment may depend on several contingent factors] and liquidity risk [it may be difficult to convert security into cash]. The various investment options are available in the securities market, the

¹⁴ Vashisht and Gupta, 2005, *Delhi Business Review* \ Vol. 8, No. 1 (January - June 2007)

investment decisions are based upon the investors' life cycle stages and the constraints of the investment decisions like liquidity, safety, return on investments, tax savings, active involvement required to manage the investment, and minimum amount requirement for selecting the instruments. After understanding the concept of investment, the investors would like to know how to go about the task of investment, how much to invest at any moment and when to buy or sell the securities, This depends on investment process as investment policy, investment analysis, valuation of securities, portfolio construction and portfolio evaluation and revision. Every investor tries to derive maximum economic advantage from his investment activity. For evaluating an investment avenues are based upon the rate of return, risk and uncertainty, capital appreciation, marketability, tax advantage and convenience of investment. The following Table 1 should give the clear picture relating to the investors' investment decisions in various financial market instruments.

Table 1: Summary Evaluation of Various Investment Avenues¹⁵

Investment options	Return		Risk Liquidity	Marketability	Tax shelter [From Income Tax Act]	Convenience
	Return yield	Capital Appreciation				
Equity Shares	Low	High	High	Fairly High	Section 80L benefit	High
Non convertible debentures	High	Negligible	Low	Average	Nil	High
Equity	Low	High	High	High	Section	Very high

¹⁵ Vashisht, A K Gupta and R K (2005) "Investment Management and Stock Market : Strategies for Successful Investing" Deep & Deep Publications Pvt Ltd. New Delhi, I Edition p.5, 10.

Schemes					80L benefit	
Debt Schemes	High	Low	Low	High	No tax on dividends	Very high
Bank Deposits	Moderate	Nil	Negligible	High	Section 80L benefit	Very high
Public Provident Fund	Nil	High	nil	Average	Section 88 benefit	Very high
Life Insurance Policies	Nil	Moderate	Nil	Average	Section 88 benefit	Very high
Residential Houses	Moderate	Moderate	Negligible	Low	High	Fair
Gold and Silver	Nil	Moderate	Average	Average	Nil	Average

It must be emphasized that within each investment category individual assets display some variations, relating to the investors risk-bearing capacity, tolerance etc., The Securities markets should discharge the important function of transfer of savings, especially of the household sector to companies, Governments and public sector bodies. Individuals or households with surplus money invest their savings in exchange for securities like shares, debentures and other form of instruments prescribed in the Securities Contract (Regulation) Act, 1956 in the way of primary or secondary market.

6.4 SUSTAINING INVESTORS' INTEREST: PRIME CONCERN

In the case of purchase of goods, the dictum of buyer beware (caveat emptor) applies. However this has limited application in respect of securities which are not physical assets capable of being inspected and selected. Investors decide to buy securities on the basis of information provided to them. If the information is incomplete or contained misrepresentation or is fraudulent, the investor stands to lose. In such a setting, it is almost impossible to sustain investor confidence for the healthy growth and development of the capital market in a country. It is thus essential to ensure providing adequate, accurate and authentic information to the investors and to safeguard them against unscrupulous promoters trying to hoodwink them. Besides, the investors need to be protected from delays in listing of securities with the stock exchanges, dispatch of allotment letters and refund orders, transfer of securities, non-payment of interest and dividend, issue of notices regarding meetings and issue of copies of the audited accounts, directors report and other relevant information which help them to take prompt decisions in keeping or disposing of their shares.

India has a comparatively higher rate of saving in the World but the investment of this savings in productive channels and in corporate securities is remarkably low. While in UK and USA 25 % of the population invests in corporate securities, only 1 % of the Indian population invests in such securities. Investment in corporate securities essentially comes from metropolitan cities, urban and semi-urban centers in India.

Information on risks involved and view points on the merits and demerits of the investment should be disseminated widely and reliably. Thus adequate, accurate, relevant and authentic information forms the core of decision making by the investors. Such information should be available on a continuous basis so that the investor is able to make disinvestments decisions also at the right time. The Intermediaries serving the investors should not only be honest but should also be competent. In the UK the Financial Services Act, 1986 has been enacted laying down strict eligibility criteria for entry as intermediary in the primary and secondary market with minimum expected level of service and administrative machinery.

All over the world the twin objectives of securities legislations are due protection of investors and proper regulation of stock exchanges and the intermediaries. For example when the great crash in the US market (Black Thursday (October 29, 1929) occurred it led to the enactment of Securities Act, 1933 and the Securities Exchange Act, 1934. The far more severe crash of Thursday (October, 19, 1987) further led to the tightening of stock market controls and regulations. In the UK in February, 1997, the Director General of Fair Trading advised the London Stock Exchange of his intention to appeal before the Restrictive Practices Court because the rules of the London Stock Exchange regarding fixed minimum commission and membership were unfair to the investors. The Government offered the Exchange an opportunity to amend these rules. The rules were amended but still could not prevent the Big Bang of October 27, 1986. Therefore, the Financial Services Act, 1986 had to be brought into effect to secure fair play in the securities business. The legislative developments in the US and UK are a joint in determining the sort of structural changes needed in regulating the Indian stock market.

6.5 INVESTORS' RIGHTS AND RESPONSIBILITIES¹⁶

Many investors may not possess adequate expertise/knowledge to take informed investment decisions. Some of them may not be aware of the complete risk-return profile of the different investment options. Some investors may not be fully aware of the precautions they should take while dealing with market intermediaries and dealing in different securities. They may not be familiar with the market mechanism and the practices as well as their rights and obligations.

6.5.1 Rights as a Shareholder

- 1) To receive the share certificates, on allotment or transfer (if opted for transaction in physical mode) as the case may be, in due time.
- 2) To receive copies of the Annual Report containing the Balance Sheet, the Profit & Loss account and the Auditor's Report.
- 3) To participate and vote in general meetings either personally or through proxy.

¹⁶ http://www.iepf.gov.in/Investor_Rights_and_Obligations.asp

- 4) To receive dividends in due time once approved in general meetings.
- 5) To receive corporate benefits like rights, bonus, etc. once approved.
- 6) To apply to Company Law Board (CLB) to call or direct the Annual General Meeting.
- 7) To inspect the minute books of the general meetings and to receive copies thereof.
- 8) To proceed against the company by way of civil or criminal proceedings.
- 9) To apply for the winding up of the company.
- 10) To receive the residual proceeds.
- 11) To receive offer to subscribe to rights shares in case of further issues of shares.
- 12) To receive offer under takeover or buyback offer under SEBI Regulations.

Besides the above rights, which you enjoy as an individual shareholder, you also enjoy the following rights as a group:

1. To requisite an Extra-ordinary General meeting.
2. To demand a poll on any resolution.
3. To apply to CLB to investigate the affairs of the company.
4. To apply to CLB for relief in cases of oppression and/or mismanagement.

6.5.2. Rights as a debenture holder

1. To receive interest/redemption in due time.
2. To receive a copy of the trust deed on request.
3. To apply before the CLB in case of default in redemption of debentures on the date of maturity.
4. To apply for winding up of the company if the company fails to pay its debt.
5. To approach the Debenture Trustee with your grievance.

It may note that the above mentioned rights may not necessarily be absolute. For example, the right to transfer securities (in physical mode) is subject to the company's right to refuse transfer as per statutory provisions.

6.5.3 Responsibilities as a security holder

While you may be happy to note that you have so many rights as a stakeholder in the company that should not lead you to complacency; because you have also certain responsibilities to discharge.

1. To be specific.
2. To remain informed.
3. To be vigilant.
4. To participate and vote in general meetings.
5. To exercise your rights on your own or as a group.

6.6 COMMON GRIEVANCES OF INVESTORS AND SHAREHOLDERS

The general grievances the investors have against companies can be listed as under:

Furnishing inadequate information or making misrepresentation in prospectus, application forms, advertisements and rights of documents.

1. Delay/non receipt of refund orders, allotment letters and share certificates/debenture certificates.
2. Delay/non-receipt of share certificates, allotment letters/debenture certificates after transfer.
3. Delay in listing of securities with stock exchanges.
4. Delay /non-receipt of share certificates/bonds/debentures after endorsement / of part payment/call money
5. Delay/non-receipt of share certificates/bonds/debentures after sub division and consolidation.
6. Delay/non-receipt of letter of offer of rights Issue
7. Delay/non-receipt of bonus shares/right shares
8. Delay/non-receipt of notices for meetings/annual reports
9. Delay/non-receipt of interest warrants and dividend warrants
10. Fixing unduly high premium on shares.
11. Difficulties in sending odd lots
12. obtaining undue benefits by company insiders

13. Delay/default in payment of interest and repayment of deposits

In respect of each of the above grievances complaints can be lodged with the registrar of Companies, stock exchanges or SEBI as the case may be in certain cases; they can be pursued with the Company Law Board also to obtain remedies and relief.

6.7 FORUMS AVAILABLE TO MAKE COMPLAINTS

The following types of grievances should be taken up with:

(a) With the Stock Exchanges:

1. Complaints related to securities traded/listed with the exchanges.
2. Complaints regarding the trades effected in the exchange with respect to the companies listed on it or by the members of the exchange.

(b) With the Department Of Company Affairs/ concerned Registrar of

Companies (ROC):

- a. Complaints against unlisted companies.
- b. Complaints regarding non-receipt of annual report, AGM Notice.
- c. Fixed deposit in manufacturing companies.

(c) With the Reserve Bank of India

Fixed deposits in banks and NBFCs

(d) With the concerned company/ROC

Forfeiture of shares

(e) With SEBI

There will be occasions when the investor has a grievance against a listed company/ intermediary registered with SEBI. In the event of such grievance you should first approach the concerned company/ intermediary against whom he has a grievance. However, he may not be satisfied with their response. Therefore, investor should know whom he should turn to, to get his grievance redressed.

SEBI takes up grievances related to issue and transfer of securities and non-payment of dividend with listed companies. In addition, SEBI also takes up grievances against the various intermediaries registered with it and related issues. Given below are types¹⁷ of grievances for which investor and shareholder could approach SEBI.

Type-I : Refund Order/ Allotment Advise

Type-II : Non-receipt of dividend.

Type-III : Non-receipt of share certificates after transfer.

Type-IV : Debentures.

Type-V : Non-receipt of letter of offer for rights.

Type VI : Collective Investment Schemes

Type VII : Mutual Funds/ Venture Capital Funds/ Foreign Venture Capital Investors/ Foreign Institutional Investors/ Portfolio Managers, Custodians.

Type VIII : Brokers/ Securities Lending Intermediaries/ Merchant Bankers/ Registrars and Transfer Agents/ Debenture Trustees/ Bankers to Issue/ Underwriters/ Credit Rating Agencies/ Depository Participants.

Type IX : Securities Exchanges/ Clearing and Settlement Organizations/ Depositories.

Type X : Derivative Trading

Type XI : Corporate Governance/ Corporate Restructuring/ Substantial Acquisition and Takeovers/ Buyback / Delisting / Compliance With Listing Conditions.

Whether investors/shareholders can file application before Consumer Forum?

Shares of debentures after they have been issued or allotted to investor are regarded as goods. In case of deficiency of service by an intermediary or listed company, an investor can approach the Consumer Forum¹⁸.

¹⁷ www.sebi.gov.in

¹⁸ section 2(1)(d) and section 12 of consumer protection act, 1986

7. REGULATORY FRAMEWORK FOR INVESTOR PROTECTION

The past few years in many ways have been remarkable for securities market in India. It has grown exponentially as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalisation, trading volumes and turnover on stock exchanges, and investor population. Along with this growth, the profiles of the investors, issuers and intermediaries have changed significantly. The market has witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements in efficiency, transparency and safety.

Reforms in the securities market, particularly the establishment and empowerment of SEBI, market determined allocation of resources, screen based nation-wide trading, dematerialisation and electronic transfer of securities, rolling settlement and ban on deferral products, sophisticated risk management and derivatives trading, have greatly improved the regulatory framework and efficiency of trading and settlement. Indian market is now comparable to many developed markets in terms of a number of qualitative parameters.

The five main legislations governing the securities market are: (a) the SEBI Act, 1992 which established SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities; and (e) the Prevention of Money Laundering Act, 2002 which prevents money laundering and provides for confiscation of property derived from or involved in money laundering.

7.1 Capital Issues (Control) Act, 1947 : The Act had its origin during the war in 1943 when the objective was to channel resources to support the war effort. It was retained with some modifications as a means of controlling the raising of capital by companies and to ensure that national resources were channelled into

proper lines, i.e. for desirable purposes to serve goals and priorities of the government, and to protect the interests of investors. Under the Act, any firm wishing to issue securities had to obtain approval from the Central Government, which also determined the amount, type and price of the issue. As a part of the liberalisation process, the Act was repealed in 1992 paving way for market determined allocation of resources.

7.2 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 issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned and adjudicate offences under the Act.

It has powers to register and regulate all market intermediaries and also to penalise 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.

7.3 Securities Contracts (Regulation) Act, 1956: It provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges and aims to prevent undesirable transactions in securities. It gives 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 conditions prescribed by Central Government. Organised trading activity in securities takes place on a specified recognised stock exchange. The stock exchanges determine their own listing regulations which have to conform to the minimum listing criteria set out in the Rules.

7.4 Depositories Act, 1996 : The Depositories Act, 1996 provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy and security by (a) making

securities of public limited companies freely transferable subject to certain exceptions; (b) dematerialising the securities in the depository mode; and (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 making the securities move from person to person. 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.

7.5 Companies Act, 1956: It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standard of disclosure in public issues of capital, 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.

7.6 Prevention of Money Laundering Act, 2002: The primary objective of the Act is to prevent money-laundering and to provide for confiscation of property derived from or involved in money-laundering. The term money-laundering is defined as whoever acquires, owns, possess or transfers any proceeds of crime; or knowingly enters into any transaction which is related to proceeds of crime either directly or indirectly or conceals or aids in the concealment of the proceeds or gains of crime within India or outside India commits the offence of money-laundering. Besides providing punishment for the offence of money-laundering, the Act also provides other measures for prevention of Money Laundering. The Act also casts an obligation on the intermediaries, banking companies etc to furnish information, of such prescribed transactions to the Financial Intelligence Unit - India, to appoint a principal officer, to maintain certain records etc.

7.7 RULES, REGULATIONS AND REGULATORS OF CAPITAL MARKET

The Government has framed rules under the SCRA, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants. The stock exchanges have also laid down their rules and regulations.

The absence of conditions of perfect competition in the securities market makes the role of regulator extremely important. The regulator ensures that the market participants behave in a desired manner so that securities market continues to be a major source of finance for corporate and government and the interest of investors are protected.

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and SEBI. The activities of these agencies are coordinated by a High Level Committee on Capital Markets. The orders of SEBI under the securities laws are appealable before a Securities Appellate Tribunal (SAT).

Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also concurrently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The rules under the securities laws are framed by government and regulations by SEBI. All these are administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The Stock Exchanges ensure compliance with their own rules as well as with the rules relevant for them under the securities laws.

8. Epilogue- The advent of joint stock companies with limited liability attracted people to invest money without fear of their unlimited liability. These persons may be investors or shareholder. The capital market has various modes of investments avenues. Besides investing, it will help the growth of economy of country and good returns to investors also. Investment in capital market can help in fund flow for productive purposes from investors and entrepreneurs. The investment in capital market can earn more returns than in saving bank interests. However, this may also have high risk factor for investors, as the capital markets are highly volatile. Therefore capital market growth depends upon investor, intermediaries and regulator of capital or securities market. The most important thing for the investors that they should invest money without fear of loosing them. For that purpose capital market regulator set up is essential. In early days no effective regulator regulated the capital markets, the market regulated by custom and ethics code prescribed by some persons. With the growth of securities market, a strong need of effective regulator arouses. In the subsequent chapters of present study, we will analyze in detail the role of SEBI and effectiveness of SEBI Laws for investor and shareholders protection keeping in view all the above aspects of Investors' Rights, Interests and Grievances.
