Share and Stock Market : Common Questions

This post is an attempt to explain common doubts regarding Share and Stock Market. We deal terms like Equity, Stock Exchange, Bull, Bear, Primary Market, Secondary Market, Depository, Depository Participant etc here. This post, 'Share and Stock Market basics' is a continuation of our article series on Financial Market. If you had not gone through our previous posts, you are advised to have a look at them first. Thanks.

Links for previous posts in the series:

1. Financial Market : Money Market and Capital Market
2. Capital Market Overview
3. Money Market Overview
4. Speculation, Hedging, Arbitrage and Investment
5. SEBI (Securities and Exchange Board of India)

What is an 'Equity'/Share?

Total **equity capital** of a company is divided into equal units of small denominations, each called a share. (Equity capital is the invested money that, in contrast to debt capital, is not repaid to the investors in the normal course of business.) For example, in a company the total equity capital of Rs 5,00,00,000 is divided into 50,00,000 units of Rs 10 each. Each such unit of Rs 10 is called a Share. Thus, the company then is said to have 50,00,000 equity shares of Rs 10 each.

NB: The holders of such shares are members of the company and have voting rights.

What is meant by a Stock Exchange?

The Securities Contract (Regulation) Act, 1956 [SCRA] defines 'Stock Exchange' as any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. Stock exchange could be a regional stock exchange or national exchanges.

What is a Depository?

A depository is like a bank wherein the deposits are securities (viz. shares, debentures, bonds, government securities, units etc.) in *electronic form*. At present there are two depositories in India, National Securities Depository Limited (NSDL) and Central Depository Services (CDS). The minimum networth stipulated by SEBI for a depository is Rs 100 crore. A depository provides the following services:

1. Dematerialisation (demat), ie. is converting physical certificates to electronic form.
2. Rematerialisation (remat), i.e. getting physical certificates from the electronic securities.

3. Transfer of securities or change of beneficial ownership.
4. Settlement of trades done on exchange connected to the Depository.

What is a Depository Participant (DP)?

A Depository Participant (DP) is an agent of the depository through which it interfaces with the investor and provides depository services. Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations /clearing houses, NBFCs and Registrar to an Issue or Share Transfer Agent complying with the requirements prescribed by SEBI can be registered as DP.

Also read: UPSC CSE Mains 2017 General Studies 3 (GS 3) Question Paper
In India, there are around 288 Depository Participants of NSDL which are registered with SEBI. Also there are 563 DPs of CSDL registered with SEBI. Some of them are given below. (NB: Banks as well as stock-brokers can act as Depository Participants).

1. State Bank of India.
2. HDFC Bank Limited.
3. ICICI Bank Limited.
4. India Infoline Limited.
5. Geojit BNP Paribas Financial Services Limited.
6. Sharekhan Limited.
7. Kotak Securities Limited.

Depository vs DP vs Investor [Image Courtesy : onemint.com]

What is Dematerialization ?

Dematerialization is the process by which physical certificates of an investor are converted to an equivalent number of securities in electronic form and credited to the investor's account with his Depository Participant (DP).

What is the function of Securities Market?

Securities Markets is a place where buyers and sellers of securities can enter into transactions to purchase and sell shares, bonds, debentures etc. Further, it performs an important role of enabling corporates, entrepreneurs to raise resources for their companies and business ventures through public issues. Transfer of resources from those having idle resources (investors) to others who have a need for them (corporates) is most efficiently achieved through the securities market. Stated formally, securities markets provide channels for reallocation of savings to investments and entrepreneurship. Savings are linked to investments by a variety of intermediaries, through a range of financial products, called 'Securities'.

What is the role of the 'Primary Market'?

The primary market provides the channel for sale of new securities. Primary market provides opportunity to issuers of securities; Government as well as corporates, to raise resources to meet their requirements of investment and/or discharge some obligation. They may issue the securities at face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt etc. They may issue the securities in domestic market and/or international market.

Why do companies need to issue shares to the public?

Most companies are usually started privately by their promoter(s). However, the promoters' capital and the borrowings from banks and financial institutions may not be sufficient for setting up or running the business over a long term. So companies invite the public to contribute towards the equity and issue shares to individual investors. The way to invite share capital from the public is through a 'Public Issue'. Simply stated, a public issue is an offer to the public to subscribe to the share capital of a company. Once this is done, the company allots shares to the applicants as per the prescribed rules and regulations laid down by SEBI.

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What is an Initial Public Offer (IPO)?

An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. It is when an unlisted company makes *either a fresh issue of securities or an offer for sale of its existing securities or both for the first time* to the public. This paves way for listing and trading of the issuer's securities. The sale of securities can be either *through book building or through normal public issue*.

What is a Prospectus ?

A large number of new companies float public issues. While a large number of these companies are genuine, quite a few may want to exploit the investors. Therefore, it is very important that an investor before applying for any issue identifies future potential of a company. A part of the guidelines issued by SEBI (Securities and Exchange Board of India) is the disclosure of *23 information to the public.* This disclosure includes information like the reason for raising the money, the way money is proposed to be spent, the return expected on the money etc. This information is in the form of 'Prospectus' which also includes information regarding the size of the issue, the current status of the company, *its equity capital*, its current and past performance, the promoters, the project, cost of the project, means of financing, product and capacity etc. It also contains lot of mandatory information regarding underwriting and statutory compliances. This helps investors to evaluate short term and long term prospects of the company.

What is meant by Market Capitalisation?

The market value of a quoted company, which is calculated by multiplying its current share price (market price) by the number of shares in issue is called as market capitalization. E.g. Company A has 120 crore shares in issue. The current market price is Rs. 100. The market capitalisation of company A is Rs. 12000 crore.

What is meant by 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.*

What is a Contract Note?

Contract Note is a confirmation of trades done on a particular day on behalf of the client by a trading member (stock broker). It imposes a legally enforceable relationship between the client and the trading member with respect to purchase/sale and settlement of trades. It also helps to settle disputes/claims between the investor and the trading member. It is a prerequisite for filing a complaint or arbitration proceeding against the trading member in case of a dispute. A valid contract note should be in the prescribed form, contain the details of trades, stamped with requisite value and duly signed by the authorized signatory. Contract notes are kept in duplicate, the trading member and the client should keep one copy each. After verifying the details contained therein, the client keeps one copy and returns the second copy to the trading member duly acknowledged by him.

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What is Insider Trading?

Insider trading is defined as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise non public information, which can be crucial for making investment decisions. When insiders (e.g. key employees or executives who have access to the strategic information about the company) use their strategic information for trading in the company's stocks or securities, it is called insider trading and is highly discouraged by the Securities and Exchange Board of India to promote fair trading in the market for the benefit of the common investor.

Bull Market vs Bear Market

A bull market is a *financial market of a group of securities* in which prices are rising or are expected to *rise. Bull markets are characterized by optimism, investor confidence and expectations that strong results will continue.*

Bear market refers to a market condition in which the prices of securities are falling, and widespread pessimism causes the negative sentiment to be self-sustaining. As investors anticipate losses in a bear market and selling continues, pessimism only grows. A bear market should not be confused with a correction, which is a short-term trend that has a duration of less than two months.