

Market Basics

What is a Stock Exchange?

A common platform where buyers and sellers come together to transact in stocks and shares. It may be a physical entity where brokers trade on a physical trading floor via an "open outcry" system or a virtual environment.

What is electronic trading?

Electronic trading eliminates the need for physical trading floors. Brokers can trade from their offices, using fully automated screen-based processes. Their workstations are connected to a Stock Exchange's central computer via satellite using Very Small Aperture Terminus (VSATs). The orders placed by brokers reach the Exchange's central computer and are matched electronically.

How many Exchanges are there in India?

The Stock Exchange, Mumbai (BSE) and the National Stock Exchange (NSE) are the country's two leading Exchanges. There are 20 other regional Exchanges, connected via the Inter-Connected Stock Exchange (ICSE). The BSE and NSE allow nationwide trading via their VSAT systems.

What is an Index?

An Index is a comprehensive measure of market trends, intended for investors who are concerned with general stock market price movements. An Index comprises stocks that have large liquidity and market capitalisation. Each stock is given a weightage in the Index equivalent to its market capitalisation. At the NSE, the capitalisation of NIFTY (fifty selected stocks) is taken as a base capitalisation, with the value set at 1000. Similarly, BSE Sensitive Index or Sensex comprises 30 selected stocks. The Index value compares the day's market capitalisation vis-a-vis base capitalisation and indicates how prices in general have moved over a period of time.

How does one execute an order?

Select a broker of your choice and enter into a broker-client agreement and fill in the client registration form. Place your order with your broker preferably in writing. Get a trade confirmation slip on the day the trade is executed and ask for the contract note at the end of the trade date.

Why does one need a broker?

As per SEBI (Securities and Exchange Board of India.) regulations, only registered members can operate in the stock market. One can trade by executing a deal only through a registered broker of a recognised Stock Exchange or through a SEBI-registered sub-broker.

What is a contract note?

A contract note describes the rate, date, time at which the trade was transacted and the brokerage rate. A contract note issued in the prescribed format establishes a legally enforceable relationship between the client and the member in respect of trades stated in the contract note. These are made in duplicate and the member and the client both keep a copy each. A client should receive the contract note within 24 hours of the executed trade. Corporate Benefits/Action

What is a book-closure / record date?

Book closure and record date help a company determine exactly the shareholders of a company as on a given date.

Book closure refers to the closing of register of the names or investors in the records of a company. Companies announce book closure dates from time to time. The benefits of dividends, bonus issues, rights issue accruing to investors whose name appears on the company's records as on a given date, is known as the record date.

An investor might purchase a share-cum-dividend, cum rights or cum bonus and may therefore expect to receive these benefits as the new shareholder. In order to receive this, the share has to be transferred in the investor's name, or he would stand deprived of the benefits. The buyer of such a share will be a loser. It is important for a buyer of a share to ensure that shares purchased at cum benefits prices are transferred before book-closure. It must be ensured that the price paid for the shares is ex-benefit and not cum benefit.

What is the difference between book closure and record date?

In case of a record date, the company does not close its register of security holders. Record date is the cut off date for determining the number of registered members who are eligible for the corporate benefits. In case of book closure, shares cannot be sold on an Exchange bearing a date on the transfer deed earlier than the book closure. This does not hold good for the record date.

What is a no-delivery period?

Whenever a company announces a book closure or record date, the Exchange sets up a no-delivery (ND) period for that security. During this period only trading is permitted in the security. However, these trades are settled only after the no-delivery period is over. This is done to ensure that investor's entitlement for the corporate benefit is clearly determined.

What is an ex-dividend date?

The date on or after which a security begins trading without the dividend (cash or stock) included in the contract price.

What is an ex-date?

The first day of the no-delivery period is the ex-date. If there is any corporate benefits such as rights, bonus, dividend announced for which book closure/record

date is fixed, the buyer of the shares on or after the ex-date will not be eligible for the benefits.

What is a Bonus Issue?

While investing in shares the motive is not only capital gains but also a proportionate share of surplus generated from the operations once all other stakeholders have been paid. But the distribution of this surplus to shareholders seldom happens. Instead, this is transferred to the reserves and surplus account. If the reserves and surplus amount becomes too large, the company may transfer some amount from the reserves account to the share capital account by a mere book entry. This is done by increasing the number of shares outstanding and every shareholder is given bonus shares in a ratio called the bonus ratio and such an issue is called bonus issue. If the bonus ratio is 1:2, it means that for every two shares held, the shareholder is entitled to one extra share. So if a shareholder holds two shares, post bonus he will hold three.

What is a Split?

A Split is book entry wherein the face value of the share is altered to create a greater number of shares outstanding without calling for fresh capital or altering the share capital account. For example, if a company announces a two-way split, it means that a share of the face value of Rs 10 is split into two shares of face value of Rs 5 each and a person holding one share now holds two shares.

What is a Buy Back?

As the name suggests, it is a process by which a company can buy back its shares from shareholders. A company may buy back its shares in various ways: from existing shareholders on a proportionate basis; through a tender offer from open market; through a book-building process; from the Stock Exchange; or from odd lot holders.

A company cannot buy back through negotiated deals on or off the Stock Exchange, through spot transactions or through any private arrangement. Clearing and Settlement

What is a settlement cycle?

The accounting period for the securities traded on the Exchange. On the NSE, the cycle begins on Wednesday and ends on the following Tuesday, and on the BSE the cycle commences on Monday and ends on Friday.

At the end of this period, the obligations of each broker are calculated and the brokers settle their respective obligations as per the rules, bye-laws and regulations of the Clearing Corporation.

If a transaction is entered on the first day of the settlement, the same will be settled on the eighth working day excluding the day of transaction. However, if the same is done on the last day of the settlement, it will be settled on the fourth working day excluding the day of transaction.

What is a rolling settlement?

The rolling settlement ensures that each day's trade is settled by keeping a fixed gap of a specified number of working days between a trade and its settlement. At present, this gap is five working days after the trading day. The waiting period is uniform for all trades.

When does one deliver the shares and pay the money to broker?

As a seller, in order to ensure smooth settlement you should deliver the shares to

your broker immediately after getting the contract note for sale but in any case before the pay-in day. Similarly, as a buyer, one should pay immediately on the receipt of the contract note for purchase but in any case before the pay-in day.
What is short selling?

Short selling is a legitimate trading strategy. It is a sale of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller. Short sellers take the risk that they will be able to buy the stock at a more favourable price than the price at which they "sold short."
What is an auction?

An auction is conducted for those securities that members fail to deliver/short deliver during pay-in. Three factors primarily give rise to an auction: short deliveries, un-rectified bad deliveries, un-rectified company objections
Is there a separate market for auctions?

The buy/sell auction for a capital market security is managed through the auction market. As opposed to the normal market where trade matching is an on-going process, the trade matching process for auction starts after the auction period is over.

What happens if the shares are not bought in the auction?

If the shares are not bought at the auction i.e. if the shares are not offered for sale, the Exchange squares up the transaction as per SEBI guidelines. The transaction is squared up at the highest price from the relevant trading period till the auction day or at 20 per cent above the last available Closing price whichever is higher. The pay-in and pay-out of funds for auction square up is held along with the pay-out for the relevant auction.

What is bad delivery?

SEBI has formulated uniform guidelines for good and bad delivery of documents. Bad delivery may pertain to a transfer deed being torn, mutilated, overwritten, defaced, or if there are spelling mistakes in the name of the company or the transfer. Bad delivery exists only when shares are transferred physically. In "Demat" bad delivery does not exist.

What are company objections?

A list documenting reasons by a company for not transferring a share in the name of an investor is called company objections. Rejection occurs due to a signature difference, or fake shares, or forgery, or if there is a court injunction preventing the transfer of the shares.

What should one do with company objections?

The broker must immediately be notified. Company objection cases should be reported within 12 months from the date of issue of the memo for the original quantity of share under objection.

Who has to replace the shares in case of company objections?

The member who has sold the shares first on the Exchange is responsible for replacing the shares within 21 days of the Exchange being informed. Company objection cases that are not rectified or replaced are normally auctioned.

How does transfer of physical shares take place?

After a sale, the share certificate along with a proper transfer deed duly stamped and

complete in all respects is sent to the company for transfer in the name of the buyer. Once the transfer is registered in the share transfer register maintained by the company, the process of transfer is complete.

Equities

What is equity?

Funds brought into a business by its shareholders is called equity. It is a measure of a stake of a person or group of persons starting a business.

What does investing in equity mean?

When you buy a company's equity, you are in effect financing it, and being compensated with a stake in the business. You become part-owner of the company, entitled to dividends and other benefits that the company may announce, but without any guarantee of a return on your investments.

What is fundamental analysis?

The analysis of factual information like financial figures, balance sheet, and other information publicly available is known as fundamental analysis. This information is used to derive a fair price of the share of the company. The faithful fundamentalists believe that the market incorporates all facts relating to the financial performance of the company. But a systematic analysis will ensure a more accurate valuation of the price. Fundamental analysts use tools such as ratio analysis (P/E, MV/BV) and discounted cash flow analysis in order to arrive at the fair value of a company and hence its share.

What are financial ratios?

A ratio is a comparison of two figures. They are culled from the financial statements of a company. These help in assessing the financial health of a company. It could be a ratio between an item from a balance sheet versus another item on the balance sheet. Or it could be a ratio between one figure of the balance sheet with a figure from Profit and Loss account or it could be comparison of one year's figure with a figure from the previous year.

For example Return on Equity = Net profit (A Profit and a Loss figure) divided by Net Worth (a balance sheet figure) in percentage terms.

What are the various kinds of financial ratios?

There are many financial ratios. Some of the better known include:

Liquidity Ratios: Liquidity ratio measures the ability of a firm to meet its current obligations. Liquidity ratios by establishing a relationship between cash and other

current assets to current obligations give measure of liquidity.

e.g. Current ratio [CR] = Current Assets/Current liabilities.

A high CR ratio (>2.5) indicates that a company can meet its short term liabilities.

Leverage Ratios: Leverage ratio indicates the proportion of debt and equity in financing the firm's assets. They indicate the funds provided by owners and lenders.

e.g. -----Debt-equity ratio (D-E ratio) total long term debt/net worth.

A high D-E ratio indicates that the company's credit profile is bad.

Activity Ratios: Activity ratios are employed to evaluate the efficiency with which firms manage and run their assets. They are also called turnover ratios.

e.g.-- Sales Turnover ratio = sales/total assets .

A Sales Turnover ratio indicates how much business a company generates for every additional rupee invested.

Profitability Ratios: These ratios indicate the level of profitability of the business with relation to the inputs or capital employed. Some better-known profit ratios include operating profit margin (OPM). Operating profit margin is a measure of the company's efficiency, either in isolation or in comparison to its peers.

What is EPS, P/E, BV and MV/BV?

Earning Per Share (EPS): EPS represents the portion of a company's profit allocated to each outstanding share of common stock. Net income (reported or estimated) for a period of time is divided by the total number of shares outstanding during that period. It is one of the measures of the profitability of common shareholder's investments. It is given by profit after tax (PAT) divided by number of common shares outstanding.

Price Earning Multiple (P/E): Price earning multiple is ratio between market value per share and earning per share.

Book Value (BV): (of a common share) The company's Net worth (which is paid-up capital + reserves & surplus) divided by number of shares outstanding.

Market value to book value ratio (MV/BV ratio): It is the ratio between the market price of a security and Book Value of the security.

What is technical analysis?

Technical analysis is the study of historic price movements of securities and trading volumes.

Technical analysts believe that prices of the securities are determined largely by forces of demand and supply. Share prices move in patterns which are easily identifiable. Crucial insights into these patterns can be obtained by keeping track of price charts, leading to predictions that a stock price may move up or down. The belief is that by knowing the past, future prices can be predicted.

Corporate Benefits / Action

What is a book-closure / record date?

Book closure refers to the closing of register of the names or investors in the records of a company. Companies announce book closure dates from time to time. The benefits of dividends, bonus issues, rights issue accruing to investors whose name appears on the company's records as on a given date, is known as the record date. Thus, book closure and record date help a company determine exactly the shareholders of a company as on a given date.

An investor might purchase a share-cum-dividend, cum rights or cum bonus and may therefore expect to receive these benefits as the new shareholder. In order to receive this, the share has to be transferred in the investor's name, or he would stand deprived of the benefits. The buyer of such a share will be a loser. It is important for a buyer of a share to ensure that shares purchased at cum benefits prices are transferred before book-closure. It must be ensured that the price paid for the shares is ex-benefit and not cum benefit.

What is the difference between book closure and record date?

In case of a record date, the company does not close its register of security holders. Record date is the cut off date for determining the number of registered members who are eligible for the corporate benefits. In case of book closure, shares cannot be sold on an Exchange bearing a date on the transfer deed earlier than the book closure. This does not hold good for the record date.

What is a no-delivery period?

Whenever a company announces a book closure or record date, the Exchange sets up a no-delivery (ND) period for that security. During this period only trading is permitted in the security. However, these trades are settled only after the no-delivery period is over. This is done to ensure that investor's entitlement for the corporate benefit is clearly determined.

What is an ex-dividend date?

The date on or after which a security begins trading without the dividend (cash or stock) included in the contract price.

What is an ex-date?

The first day of the no-delivery period is the ex- date. If there is any corporate benefits such as rights, bonus, dividend announced for which book closure/record date is fixed, the buyer of the shares on or after the ex -date will not be eligible for the benefits.

Why is "new share dividend" deducted from the sale price of shares?

In case a company issues new shares in any financial year, then these shares are eligible only for pro rata dividend in respect of the financial year in which these are issued. The old and the new shares thus carry disproportionate rights as to dividend, although their market price remains the same. To compensate the buyer to whom these new shares are delivered for loss of pro rata dividend, the seller of new shares has to pay to the buyer, the dividend declared in respect of old shares. This old-new compensatory value is called as new share dividend. The Exchange publishes a list of the scrips that are eligible to receive the pro rata dividend per settlement.

What is a bonus issue?

While investing in shares the motive is not only capital gains but also proportionate share of surplus generated from the operations once all other stakeholders have been paid. But the distribution of this surplus to shareholders seldom happens. Instead, this is transferred to the reserves and surplus account. If the reserves and surplus amount becomes too large, the company may transfer some amount from the reserves account to the share capital account by a mere book entry. This is done by increasing the number of shares outstanding and every shareholder is given bonus shares in a ratio called the bonus ratio and such an issue is called bonus issue. If the bonus ratio is 1:2, it means that for every two shares held, the shareholder is entitled to one extra share. Thus a shareholder holding two shares, post bonus holds three shares of the company.

What is a split?

Split is book entry wherein the face value of the share is altered to create more number of shares outstanding without calling for fresh capital or without altering the share capital account. For example if a company announces a two-way split, it means that a share of the face value of Rs.10 is split into two shares of face value Rs.five each and a person holding one share now holds two shares.

What is buy-back?

It is a process by which a company can buy-back its shares from shareholders. A company may buy-back its shares in various ways :

- from existing shareholders on a proportionate basis through a tender offer
- from open market through book-building process
- from the Stock Exchange
- from odd lot holders

A company cannot buy-back its shares through negotiated deals, whether on or off the Stock Exchange or through spot transactions or through any private arrangement

Clearing and Settlement

What is a settlement cycle?

Settlement cycle is the accounting period for the securities traded on the Exchange. On the NSE the cycle begins on Wednesday and ends on the following Tuesday, while on the BSE the cycle commences on Monday and ends on Friday. At the end of this period, the obligations of each broker is calculated and the brokers settle their respective obligations as per the rules, bye-laws and regulations of the Clearing Corporation.

NSE settlement cycle at a glance

Date	Particulars	Activity
1-7	Wednesday-Tuesday	Trading Period
8	Wednesday	Custodians report trades which they will not settle. Such trades will be added to the member obligation.
13	Monday	Pay-in of securities, delivery of documents by the delivery members at the Clearing House.
14	Tuesday	Pay-in funds by members through the Clearing Bank. Shortage identification at Clearing House.
15	Wednesday	Pay-out day for Securities and Funds. Auction for shortages.
17	Friday	Auction pay-in day for Securities and Funds. Bad delivery reporting by the receiving member to the Clearing House and intimation to the delivering member.
18	Saturday	Auction pay-out. Pick-up of bad deliveries for rectification.
20	Monday	Bad delivery rectification/replacement by the delivering member.
22	Wednesday	Auction for bad delivery not rectified/replaced.
23	Thursday	Bad delivery auction pay-in.
24	Friday	Bad delivery auction pay-out.

BSE settlement cycle at a glance

Day	Activity
Monday to Friday	Trading on BOLT and daily downloading of statement showing details of transactions and margin statement, at the end of each trading day.
Saturday	Carry Forward Session (for 'A' Group Securities) and downloading of money statement.
Monday	Marking the mode of delivery – physical or demat
Wednesday	Pay-in of physical securities.
Thursday	Delivery of securities in the Clearing House as per prescribed time slots upto 1:00 p.m. only. Debiting of members' bank accounts having payable position at 5:00 p.m. Reconciliation of securities delivered and amounts claimed.
Friday	Pay-out (Physical securities only)

Saturday	Funds pay-out
----------	---------------

If a transaction is entered on the first day of the settlement, i.e. Monday, the same will be settled on the eighth working day excluding the day of transaction. However, if the same is done on the last day of the settlement, i.e., Friday, it will be settled on the fourth working day excluding the day of transaction.

Settlement cycle is the accounting period for the securities traded on the exchange. On the NSE the cycle begins on Wednesday and ends on the following Tuesday, while on the BSE the cycle commences on Monday and ends on Friday. At the end of this period, the obligations of each broker is calculated and the brokers settle their respective obligations as per the rules, bye-laws and regulations of the clearing corporation.

What is a rolling settlement?

The rolling settlement ensures that each day's trade is settled by keeping a fixed gap, between a trade and its settlement, of a specified number of working days. At present this is five working days after the trading day. The waiting period is uniform for all trades.

When does one deliver the shares/pay the money to broker?

In order to ensure smooth settlement one should deliver the shares to your broker immediately after getting the contract note for sale but in any case before the pay-in day. Similarly on the purchase of securities, one should pay immediately on the receipt of the contract note for purchase but in any case before the pay-in day.

When does one get shares / money from the broker?

The shares and the funds are paid out to the broker on pay-out day. The trading member should pay the money or securities to the investor within 48 hours of the pay-out.

What is short selling?

It is a sale of a security that the seller does not own, or any sale that is completed by the delivery of a security borrowed by the seller. Short selling is a legitimate trading strategy. Short sellers assume the risk that they will be able to buy the stock at a more favourable price than the price at which they sold short.

What is an auction?

Auction is conducted for those securities that members fail to deliver/short deliver during pay-in.

Is there a separate market for auction?

The buy/sell auction for a capital market security is managed through the auction market. As opposed to the normal market where trade matching is an on-going process, the trade matching process for auction starts after the auction period is over.

What factors give rise to an auction?

There are three factors which primarily give rise to an auction:

- short Deliveries
- un-rectified bad deliveries
- un-rectified company objections

What happens if the shares are not bought in the auction?

If the shares are not bought at the auction i.e. if the shares are not offered for sale, the Exchange squares up the transaction as per SEBI guidelines. The transaction is squared up at the highest price from the relevant trading period till the auction day or at 20 per cent above the last available closing price whichever is higher. The pay-in and pay-out of funds for auction square up is held along with the pay-out for the relevant auction.

What is bad delivery?

SEBI has formulated uniform guidelines for good and bad delivery of documents. Bad delivery may pertain to transfer deed being torn, mutilated, overwritten, defaced, or if there are spelling mistakes in the name of the company or the transfer. Bad delivery exists only when shares are transferred physically. In "Demat" (SEE DEMAT) bad delivery does not exist.

What are company objections?

A list documenting reasons by a company for not transferring a share in the name of an investor is called company objections. Rejection occurs due to a signature difference, or fake shares, forged, or if there is a court injunction preventing the transfer of the shares.

What should one do with company objections?

The broker must immediately be notified. Company objection cases should be reported within 12 months from the date of issue of the memo for the original quantity of share under objection.

Who has to replace the shares in case of company objections?

It is the responsibility of the member who has sold the shares first on the Exchange to replace the shares within 21 days of the Exchange being informed. Company objection cases that are not rectified/ replaced are normally auctioned.

What is a stop transfer case?

Stop transfer is the process whereby the transfer of securities is stopped by the company for valid reasons as provided in the Companies Act, 1956. The process is effected by a company on the strength of a copy of a First Information Report (FIR) or a Court order, when the securities are reported as missing/lost/ stolen by the holder of the securities.

How does transfer of physical shares take place?

After a sale, the share certificate along with a proper transfer deed duly stamped and complete in all respects is sent to the company for transfer in the name of the buyer. Once the transfer is registered in the share transfer register maintained by the company, the process of transfer is complete.

What is a complete transfer deed?

A deed of transfer is considered proper if it is :

- in the prescribed format dated by the prescribed authority (eg. Registrar of Companies) and its validity period has not expired.
- must be duly stamped @0.50 per cent of the trade value of the shares as on the date of execution of the transfer deed.
- duly signed by or on behalf of the transferor and the transferee.

Dematerialisation

What is Demat?

Demat is a commonly used abbreviation of Dematerialisation, which is a process whereby securities like shares, debentures are converted from the "material" (paper documents) into electronic data and stored in the computers of an electronic Depository (SEE next page).

You surrender material securities registered in your name to a Depository Participant (DP). These are then sent to the respective companies who cancel them after dematerialisation and credit your Depository Account with the DP. The securities on dematerialisation appear as balances in the Depository Account. These balances are transferable like physical shares. If at a later date you wish to have these "Demat" securities converted back into paper certificates, the Depository can help to revive the paper shares.

What is the procedure for the dematerialisation of securities?

Check with a DP as to whether the securities you hold can be dematerialised. Then open an account with a DP and surrender the share certificates.

What is a Depository?

A Depository is a securities "bank," where dematerialised physical securities are held in custody, and from where they can be traded. This facilitates faster, risk-free and low cost settlement. A Depository is akin to a bank and performs activities similar in nature.

At present, there are two Depositories in India, National Securities Depository Limited (NSDL) and Central Depository Services (CDS). NSDL was the first Indian Depository. It was inaugurated in November 1996. NSDL was set up with an initial capital of Rs 124 crore, promoted by Industrial Development Bank of India (IDBI), Unit Trust of India (UTI), National Stock Exchange of India Ltd. (NSEIL) and the State Bank of India (SBI).

Who is a Depository Participant (DP)?

NSDL carries out its activities through business partners - Depository Participants (DPs), Issuing Corporates and their Registrars and Transfer Agents, Clearing Corporations/Clearing Houses. NSDL is electronically linked to each of these business partners via a satellite link through Very Small Aperture Terminals (VSATS). The entire integrated system (including the VSAT linkups and the software at NSDL and at each business partner's end) has been named the "NEST" (National Electronic Settlement & Transfer) system. The investor interacts with the Depository through a Depository Participant of NSDL. A DP can be a bank, financial institution, a custodian or a broker

Market Operations

What is ALBM? How does it work?

ALBM is an acronym for automated lending/borrowing mechanism. It is a stock-lending product introduced by NSCCL (National Securities Clearing Corporation Limited) with the primary objective of providing a window for trading members of NSE to borrow securities/funds to meet their pay-in obligations. ALBM sessions are held every Wednesday for weekly markets and every day for rolling market. ALBM trades are carried out at a spot price called "Transaction Price"(TP), while positions are reversed at a benchmark price called "Securities Lending Price" (SLP). The difference between the SLP and the TP is the return from borrowing or lending funds or securities. ALBM is a means of facilitating sophisticated trading strategies giving good returns.

Let's take an example to demonstrate this mechanism:

A is a trader who has short sold Infosys. He wants to carry forward his position but as the settlement has ended, he must meet his delivery obligation. Trader B holds shares of Infosys. He does not want to sell but at the same time, he wants to maximise returns on his portfolio, taking advantage of whatever opportunities come along.

On the ALBM session on Wednesday, the SLP for Infosys is, say, Rs.8000. Trader B places a sell order for 100 shares of Infosys at Rs.8040 (transaction price). Trader A looking for an opportunity, grabs the shares and the transaction is executed. In effect, Trader B has lent 100 shares of Infosys to Trader A for a fee of Rs 40 per share. Trader A pays Rs 8,00,000 (Rs. 8,000 x 100) as collateral and Rs 4000

towards fees for the loan of securities. In the process, Trader B gets a weekly return of 0.50% or 26% annualised.

Is ALBM similar to carry forward?

This may sound suspiciously like carry forward. But there are some major differences between a carry forward transaction and stock lending transaction.

- carry forward is a leveraged transaction, where the investor has to pay 10 to 15 per cent margin. Stock lending is a 100 per cent margin transaction.
- carry forward positions can be rolled over for a maximum period of 90 days. In the case of stock lending, the positions have to be settled within a nine-day period.
- carry forward market is characterised by the absence of institutions. Advent of stock lending will bring institutions also into the carry forward market. This will improve the carry forward market.

What is hawala rate?

Hawala rate is a making-up price at which buyers and sellers settle their speculative transactions at the end of the settlement. It is the basis for buy and sell for the investor opting for carry forward during the next settlement. This price is fixed by taking the weighted average of trades in the last half-an-hour of trading on the settlement day for securities in the carry forward list, also known as the "A" group or specified group. This price is significant because for a speculative buyer or a seller, the *hawala* rate is the standard rate for settling his trade and for carrying forward business to the next settlement. For example, An investor buys the stock of X company at Rs.100 on Monday. By Friday (BSE settlement day), if Rs.90 is the weighted average price in the last half-an-hour, the buyer would have to carry forward his trade at this price of Rs.90. He then settles at Rs.90 and enters into a contract at Rs.90 plus *BLESS* charges for the next settlement.

Can the Stock Exchange fix or alter the hawala rate?

Normally, Stock Exchanges do not interfere with the *hawala* rates. However, there are instances, when rates have been changed to ensure safety of the markets. This is so because in case the market witnesses a sharp fall during a settlement, the chances of a broker default are extremely high. This is when the Exchange administration steps in and raises the *hawala* rate to avert any possible default.

What is Arbitrage?

Arbitrage is an act of buying assets (or securities) in one market and selling in another at higher prices. It takes advantage of a price differential existing in the prices of the same commodity or security in two or more different markets. By this process, undervalued assets (or securities) are sold in related markets, which are temporarily out of equilibrium. It should be understood that unlike speculation, arbitrage is risk-free as opposite positions (i.e long-short) are taken simultaneously, leaving no uncovered position.

Since Indian Stock Exchanges trade the same stocks with different settlement periods, there are many opportunities for arbitrage.

IPOs

What is an IPO?

An IPO is an abbreviation for Initial Public Offer. When a company goes public for the first time or issues a fresh stock of shares, it offers it to the public directly. This happens in the primary market. The primary market is where a company makes its first contact with the public at large.

What is Book Building?

Book Building is a process used for marketing a public offer of equity shares of a company and is a common practice in most developed countries. Book Building is so-called because the collection of bids from investors are entered in a "book". These bids are based on an indicative price range. The issue price is fixed after the bid closing date.

How is the book built?

A company that is planning an initial public offer (IPO) appoints a category-I Merchant Banker as a bookrunner. Initially, the company issues a draft prospectus which does not mention the price, but gives other details about the company with regards to issue size, past history and future plans among other mandatory disclosures. After the draft prospectus is filed with the SEBI, a particular period is fixed as the bid period and the details of the issue are advertised. The book runner builds an order book, that is, collates the bids from various investors, which shows the demand for the shares of the company at various prices. For instance, a bidder may quote that he wants 50,000 shares at Rs.500 while another may bid for 25,000 shares at Rs.600. Prospective investors can revise their bids at anytime during the bid period, that is, the quantity of shares or the bid price or any of the bid options. Usually, the bid must be for a minimum of 500 equity shares and in multiples of 100 equity shares thereafter. The book runner appoints a syndicate member, a registered intermediary who garners subscription and underwrites the issue.

On what basis is the final price decided?

On closure of the book, the quantum of shares ordered and the respective prices offered are known. The price discovery is a function of demand at various prices, and involves negotiations between those involved in the issue. The book runner and the company conclude the pricing and decide the allocation to each syndicate member.

When is the payment for the shares made?

The bidder has to pay the maximum bid price at the time of bidding based on the highest bidding option of the bidder. The bidder has the option to make different bids like quoting a lower price for higher number of shares or a higher price for lower number of shares. The syndicate member may waive the payment of bid price at the

time of bidding. In such cases, the issue price may be paid later to the syndicate member within four days of confirmation of allocation. Where a bidder has been allocated lesser number of shares than he or she had bid for, the excess amount paid on bidding, if any will be refunded to such bidder.

Is the process followed in India different from abroad?

Unlike international markets, India has a large number of retail investors who actively participate in IPOs. Internationally, the most active investors are the Mutual Funds and Other Institutional Investors. So the entire issue is book built. But in India, 25 per cent of the issue has to be offered to the general public. Here there are two options to the company. According to the first option, 25 per cent of the issue has to be sold at a fixed price and 75 per cent is through Book Building. The other option is to split the 25 per cent on offer to the public (small investors) into a fixed price portion of 10 per cent and a reservation in the book built portion amounting to 15 per cent of the issue size. The rest of the book built portion is open to any investor.

What is the advantage of the Book Building process versus the normal IPO marketing process?

The Book Building process allows for price and demand discovery. Also, the costs of the public issue is reduced and so is the time taken to complete the entire process.

How is Book building different from the normal IPO marketing process as practiced in India?

Unlike in Book Building, IPOs are usually marketed at a fixed price. Here the demand cannot be anticipated by the merchant banker and only after the issue is over the response is known. In book building, the demand for the share is known before the issue closes. The issue may be deferred if the demand is less