Short Selling

Normal trading sale would involve action of buying firstly followed with selling. But selling would precede buying during the intervening settlement period in case of securities trading. In India, short selling of securities is not fully developed beyond the period of settlement. In developed nations, short selling increases the pitch of activities in securities market. This short selling would involve the fullest benefit to especially to investors and generally to the security market and nation.

Short selling involves selling securities that are not owned. An investor might contact his broker to short 500 Reliance shares. The broker will then borrow the shares from another client and sell them in the open market in the usual way. The investor can maintain the short position for as long as he or she chooses provided there are always shares for the broker to borrow. At some stage, however, the investor will close out the position by purchasing 500 Reliance shares. These are then replaced in the account of the client from which the shares were borrowed. The investor makes a profit if the stock price has declined and a loss if it has risen. If, at any time while the contract is open, the broker runs out of shares to borrow, the investor is *short-squeezed* and is forced to close out the position immediately even though he or she may not be ready to do so.

A broker requires significant initial margins from clients with short positions, if there are adverse movements (i.e., increases) in the price of the security, additional margin may be required. The proceeds of the initial sales of the security belong to the investor and normally form part of the margin account.

An investor with a short position must pay to his broker any income such as dividends or interest that would normally be received on the securities that have been shorted. The broker will transfer this to the account of the client from whom the securities have been borrowed.