Equity Investments

Meaning of Securities

The definition of 'Securities' as per the Securities Contracts Regulation Act (SCRA), 1956, includes instruments such as shares, bonds, scrips, stocks or other marketable securities of similar nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, interest and rights in securities, security receipt or any other instruments so declared by the Central Government.

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'.

Investment Securities

- Shares
- Government Securities
- Derivative products
- Units of Mutual Funds etc., are some of the securities investors in the securities market can invest in.

Participants in the Securities Market

The securities market essentially has three categories of participants, namely, the issuers of securities, investors in securities and the intermediaries, such as merchant bankers, brokers etc. While the corporates and government raise resources from the securities market to meet their obligations, it is households that invest their savings in the securities market.

It is advisable to conduct transactions through an intermediary. For example you need to transact through a trading me mber of a stock exchange if you intend to buy or sell any security on stock exchanges. You need to maintain an account with a depository if you intend to hold securities in demat form. You need to deposit money with a banker to an issue if you are subscribing to public issues. You get guidance if you are transacting through an intermediary. Chose a SEBI registered intermediary, as he is accountable for its activities. The list of registered intermediaries is available with exchanges, industry associations etc.

Segments of Securities Market

The securities market has two interdependent segments: the primary (new issues) market and the secondary market. The primary market provides the channel for sale of new securities while the secondary market deals in securities previously issued.

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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.

Face Value of a share/debenture

The nominal or stated amount (in Rs.) assigned to a security by the issuer. For shares, it is the original cost of the stock shown on the certificate; for bonds, it is the amount paid to the holder at maturity. Also known as par value or simply par. For an equity share, the face value is usually a very small amount (Rs. 5, Rs. 10) and does not have much bearing on the price of the share, which may quote higher in the market, at Rs. 100 or Rs. 1000 or any other price. For a debt security, face value is the amount repaid to the investor when the bond matures (usually, Government securities and corporate bonds have a face value of Rs. 100). The price at which the security trades depends on the fluctuations in the interest rates in the economy.

Securities are generally issued in denominations of 5, 10 or 100. This is known as the Face Value or Par Value of the security as discussed earlier. When a security is sold above its face value, it is said to be issued at a Premium and if it is sold at less than its face value, then it is said to be issued at a Discount.

Issue of Shares

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.

Primarily, issues can be classified as a Public, Rights or Preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler. The classification of issues is illustrated below:

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Initial Public Offering (IPO) 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.

A follow on public offering (Further Issue) is when an already listed company makes either a fresh issue of securities to the public or an offer for sale to the public, through an offer document.

Rights Issue is when a listed company which proposes to issue fresh securities to its existing shareholders as on a record date. The rights are normally offered in a particular ratio to the number of securities held prior to the issue. This route is best suited for companies who would like to raise capital without diluting stake of its existing shareholders.

A Preferential issue is an issue of shares or of convertible securities by listed companies to a select group of persons under Section 81 of the Companies Act, 1956 which is neither a rights issue nor a public issue. This

is a faster way for a company to raise equity capital. The issuer company has to comply with the Companies Act and the requirements contained in the Chapter pertaining to preferential allotment in SEBI guidelines which inter-alia include pricing, disclosures in notice etc.

The price at which a company's shares are offered initially in the primary market is called as the Issue price. When they begin to be traded, the market price may be above or below the issue price.

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 million shares in issue. The current market price is Rs. 100. The market capitalisation of company A is Rs. 12000 million.

Difference between public issue and private placement

When an issue is not made to only a select set of people but is open to the general public and any other investor at large, it is a public issue. But if the issue is made to a select set of people, it is called private placement. As per Companies Act, 1956, an issue becomes public if it results in allotment to 50 persons or more. This means an issue can be privately placed where an allotment is made to less than 50 persons.

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.

Indian primary market ushered in an era of free pricing in 1992. Following this, the guidelines have provided that the issuer in consultation with Merchant Banker shall decide the price. There is no price formula stipulated by SEBI. SEBI does not play any role in price fixation. The company and merchant banker are however required to give full disclosures of the parameters which they had considered while deciding the issue price. There are two types of issues, one where company and Lead Merchant Banker fix a price (called fixed price) and other, where the company and the Lead Manager (LM) stipulate a floor price or a price band and leave it to market forces to determine the final price (price discovery through book building process).

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Book Building is basically a process used in IPOs for efficient price discovery. It is a mechanism where, during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date.

Price at which securities will be allotted is not known in case of offer of shares through Book Building while in case of offer of shares through normal public issue, price is known in advance to investor. Under Book Building, investors bid for shares at the floor price or above and after the closure of the book building process the price is determined for allotment of shares.

In case of Book Building, the ***demand*** can be known everyday as the book is being built. But in case of the public issue the demand is known at the close of the issue.
In a Book building issue, the issuer is required to indicate either the price band or a floor price in the prospectus. The actual discovered issue price can be any price in the price band or any price above the floor price. This issue price is called "Cut-Off Price". The issuer and lead manager decides this after considering

the book and the investors' appetite for the stock. Floor price is the minimum price at which bids can be made.

The prospectus may contain either the floor price for the securities or a price band within which the investors can bid. The spread between the floor and the cap of the price band shall not be more than 20%. In other words, it means that the cap should not be more than 120% of the floor pric e. The price band can have a revision and such a revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing a press release and also indicating the change on the relevant website and the terminals of the trading me mbers participating in the book building process. In case the price band is revised, the bidding period shall be extended for a further period of three days, subject to the total bidding period not exceeding ten days.

It may be understood that the regulatory mechanism does not play a role in setting the price for issues. It is up to the company to decide on the price or the price band, in consultation with Merchant Bankers. The Book should remain open for a minimum of 3 days. Individual investors can also use use the book building facility to make an application in an IPO.

As per SEBI guidelines, the Basis of Allotment should be completed with 15 days from the issue close date. As soon as the basis of allotment is completed, within 2 working days the details of credit to demat account / allotment advice and despatch of refund order needs to be completed. So an investor should know in about 15 days time from the closure of issue, whether shares are allotted to him or not.

It would take around 3 weeks after the closure of the book built issue to get the shares listed after issue.

Role of a 'Registrar' to an issue

The Registrar finalizes the list of eligible allottees after deleting the invalid applications and ensures that the corporate action for crediting of shares to the demat accounts of the applicants is done and the dispatch of refund orders to those applicable are sent. The Lead Manager coordinates with the Registrar to ensure follow up so that that the flow of applications from collecting bank branches, processing of the applications and other matters till the basis of allotment is finalized, dispatch security certificates and refund orders completed and securities listed.

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 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.

Draft Offer Document

'Offer document' means *Prospectus* in case of a public issue or offer for sale and *Letter of Offer* in case of a

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rights issue which is filed with the Registrar of Companies (ROC) and Stock Exchanges (SEs). An offer document covers all the relevant information to help an investor to make his/her investment decision.

'Draft Offer document' means the offer document in draft stage. The draft offer documents are filed with SEBI, atleast 21 days prior to the filing of the Offer Document with ROC/SEs. SEBI may specify changes, if any, in the draft Offer Document and the issuer or the lead merchant banker shall carry out such changes in the draft offer document before filing the Offer Document with ROC/SEs. The Draft Offer Document is available on the SEBI website for public comments for a period of 21 days from the filing of the Draft Offer Document with SEBI.

'Abridged Prospectus' is a shorter version of the Prospectus and contains all the salient features of a Prospectus. It accompanies the application form of public issues.

Generally, the public issues of companies are handled by *'Merchant Bankers'* who are responsible for getting the project appraised, finalizing the cost of the project, profitability estimates and for preparing of 'Prospectus'. The 'Prospectus' is submitted to SEBI for its approval.

Lock-in

'Lock-in' indicates a freeze on the sale of shares for a certain period of time. SEBI guidelines have stipulated lock-in requirements on shares of promoters mainly to ensure that the promoters or main persons, who are controlling the company, shall continue to hold some minimum percentage in the company after the public issue.

Listing of Securities

Listing means admission of securities of an issuer to trading privileges (dealings) on a stock exchange through a formal agreement. The prime objective of admission to dealings on the exchange is to provide liquidity and marketability to securities, as also to provide a mechanism for effective control and supervision of trading.

At the time of listing securities of a company on a stock exchange, the company is required to enter into a listing agreement with the exchange. The listing agreement specifies the terms and conditions of listing and the disclosures that shall be made by a company on a continuous basis to the exchange.

The term 'Delisting of securities' means permanent removal of securities of a listed company from a stock exchange. As a consequence of delisting, the securities of that company would no longer be traded at that stock exchange.

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SEBI's Role in an Issue

Any company making a public issue or a listed company making a rights issue of value of more than Rs 50 lakh is required to file a draft offer document with SEBI for its observations. The company can proceed further on the issue only after getting observations from SEBI. The validity period of SEBI's observation letter is three months only i.e. the company has to open its issue within three months period.

SEBI does not recommend any issue nor does take any responsibility either for the financial soundness of any scheme or the project for which the issue is proposed to be made or for the correctness of the statements made or opinions expressed in the offer document. SEBI mainly scrutinizes the issue for seeing that adequate disclosures are made by the issuing company in the prospectus or offer document.

The investors should make an informed decision purely by themselves based on the contents disclosed in the offer documents. SEBI does not associate itself with any issue/issuer and should in no way be construed as a guarantee for the funds that the investor proposes to invest through the issue. However, the investors are generally advised to study all the material facts pertaining to the issue including the risk factors before considering any investment. They are strongly warned against relying on any 'tips' or news through unofficial means.

Foreign Capital Issuance

Indian companies are permitted to raise foreign currency resources through two main sources: a) issue of foreign currency convertible bonds more commonly known as 'Euro' issues and b) issue of ordinary shares through depository receipts namely 'Global Depository Receipts (GDRs)/American Depository Receipts (ADRs)' to foreign investors i.e. to the institutional investors or individual investors.

American Depository Receipt

An American Depositary Receipt ("ADR") is a physical certificate evidencing ownership of American Depositary Shares ("ADSs"). The term is often used to refer to the ADSs themselves.

An American Depositary Share ("ADS") is a U.S. dollar denominated form of equity ownership in a non-U.S. company. It represents the foreign shares of the company held on deposit by a custodian bank in the company 's home country and carries the corporate and economic rights of the foreign shares, subject to the terms specified on the ADR certificate.

One or several ADSs can be represented by a physical ADR certificate. The terms ADR and ADS are often used interchangeably.

ADSs provide U.S. investors with a convenient way to invest in overseas securities and to trade non-U.S. securities in the U.S. ADSs are issued by a depository bank, such as JPMorgan Chase Bank. They are traded in the same manner as shares in U.S. companies, on the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX) or quoted on NASDAQ and the over-the-counter (OTC) market.

Although ADSs are U.S. dollar denominated securities and pay dividends in U.S. dollars, they do not eliminate the currency risk associated with an investment in a non-U.S. company.

Global Depository Receipts

Global Depository Receipts (GDRs) may be defined as a global finance vehicle that allows an issuer to raise capital simultaneously in two or markets through a global offering. GDRs may be used in public or private markets inside or outside US. GDR, a negotiable certificate usually represents company's traded equity/debt. The underlying shares correspond to the GDRs in a fixed ratio say 1 GDR=10 shares.

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.

For the general investor, the secondary market provides an efficient platform for trading of his securities. For the management of the company, Secondary equity markets serve as a monitoring and control

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conduit—by facilitating value-enhancing control activities, enabling implementation of incentive-based management contracts, and aggregating information (via price discovery) that guides management decisions.

In the primary market, securities are offered to public for subscription for the purpose of raising capital or fund. Secondary market is an equity trading venue in which already existing/pre-issued securities are traded among investors. Secondary market could be either auction or dealer market. While stock exchange is the part of an auction market, Over-the-Counter (OTC) is a part of the dealer market.

STOCK EXCHANGES

The stock exchanges in India, under the overall supervision of the regulatory authority, the Securities and Exchange Board of India (SEBI), provide a trading platform, where buyers and sellers can meet to transact in securities. The trading platform provided by BSE & NSE are electronic one and there is no need for buyers and sellers to meet at a physical location to trade. They can trade through the computerized trading screens available with the Exchange trading members or the internet based trading facility provided by the trading members.

Demutualisation refers to the legal structure of an exchange whereby the ownership, the management and the trading rights at the exchange are segregated from one another.

In a mutual exchange, the three functions of ownership, management and trading are concentrated into a single Group. Here, the broker members of the exchange are both the owners and the traders on the exchange and they further manage the exchange as well. This at times can lead to conflicts of interest in decision making. A demutualised exchange, on the other hand, has all these three functions clearly segregated, i.e. the ownership, management and trading are in separate hands.

Screen Based Trading

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The trading on stock exchanges in India used to take place through open outcry without use of information technology for immediate matching or recording of trades. This was time consuming and inefficient. This imposed limits on trading volumes and efficiency. In order to provide efficiency, liquidity and transparency, NSE introduced a nationwide, on-line, fully-automated screen based trading system (SBTS) where a member can punch into the computer the quantities of a security and the price at which he would like to transact, and the transaction is executed as soon as a matching sale or buy order from a counter party is found.

An investor may go to the broker's office or place an order on the phone/internet or as defined in the *Model Agreement*, which every client needs to enter into with his or her broker.

Contract Note

Contract Note is a confirmation of trades done on a particular day on behalf of the client by a trading member. 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.

A broker has to issue a contract note to clients for all transactions in the form specified by the stock exchange. The contract note inter-alia should have following:

- Name, address and SEBI Registration number of the Member broker.
- Name of partner/proprietor/Authorised Signatory.
- Dealing Office Address/Tel. No./Fax no., Code number of the member given by the Exchange.
- Contract number, date of issue of contract note, settlement number and time period for settlement.
- Constituent (Client) name/Code Number.
- Order number and order time corresponding to the trades.
- Trade number and Trade time.
- Quantity and kind of Security bought/sold by the client.
- Brokerage and Purchase/Sale rate.
- Service tax rates, Securities Transaction Tax and any other charges levied by the broker.
- Appropriate stamps have to be affixed on the contract note or it is mentioned that the consolidated stamp duty is paid.
- Signature of the Stock broker/Authorized Signatory.

The maximum brokerage that can be charged by a broker from his clients as commission cannot be more than 2.5% of the value mentioned in the respective purchase or sale note.

An investor does not get any protection if he trades outside a stock exchange. Trading at the exchange offers investors the best prices prevailing at the time in the market, lack of any counter-party risk which is assumed by the *clearing corporation*, access to investor grievance and redressal mechanism of stock exchanges, protection upto a prescribed limit, from the Investor Protection Fund etc.

One can confirm if a Broker is registered by verifying the registration certificate issued by SEBI. A broker's registration number begins with the letters 'INB' and that of a sub broker with the letters 'INS'.

Precautions must one take before investing in the stock markets

- Here are some useful pointers to bear in mind before you invest in the markets:
- Make sure your broker is registered with SEBI and the exchanges and do not deal with unregistered intermediaries.
- Ensure that you receive contract notes for all your transactions from your broker within one working day of execution of the trades.
- All investments carry risk of some kind. Investors should always know the risk that they are taking and invest in a manner that matches their risk tolerance.
- Do not be misled by market rumours, luring advertisement or 'hot tips' of the day.
- Take informed decisions by studying the fundamentals of the

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- company. Find out the business the company is into, its future prospects, quality of management, past track record etc Sources of knowing about a company are through annual reports, economic magazines, databases available with vendors or your financial advisor.

- If your financial advisor or broker advises you to invest in a company you have never heard of, be cautious. Spend some time checking out about the company before investing.

- Do not be attracted by announcements of fantastic results/news reports, about a company. Do your own research before investing in any stock.

- Do not be attracted to stocks based on what an internet website promotes, unless you have done adequate study of the company.

- Investing in very low priced stocks or what are known as penny stocks does not guarantee high returns.

- Be cautious about stocks which show a sudden spurt in price or trading activity.

- Any advise or tip that claims that there are huge returns expected, especially for acting quickly, may be risky and may to lead to losing some, most, or all of your money.

Do's and Don'ts an investor should bear in mind when investing in the stock markets

- Ensure that the intermediary (broker/sub-broker) has a valid SEBI registration certificate.

- Enter into an agreement with your broker/sub-broker setting out terms and conditions clearly.

- Ensure that you give all your details in the 'Know Your Client' form.

- Ensure that you read carefully and understand the contents of the

- 'Risk Disclosure Document' and then acknowledge it.

- Insist on a contract note issued by your broker only, for trades done each day.

- Ensure that you receive the contract note from your broker within 24 hours of the transaction.

- Ensure that the contract note contains details such as the broker's name, trade time and number, transaction price, brokerage, service tax, securities transaction tax etc. and is signed by the Authorised Signatory of the broker.

- Issue account payee cheques/demand drafts in the name of your broker only, as it appears on the contract note/SEBI registration certificate of the broker.

- While delivering shares to your broker to meet your obligations, ensure that the delivery instructions are made only to the designated account of your broker only.

- Insist on periodical statement of accounts of funds and securities from your broker. Cross check and reconcile your accounts promptly and in case of any discrepancies bring it to the attention of your broker immediately.

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- Please ensure that you receive payments/deliveries from your broker, for the transactions entered by you, within one working day of the payout date.

- Ensure that you do not undertake deals on behalf of others or trade on your own name and then issue cheques from a family members'/ friends' bank accounts.

- Similarly, the Demat delivery instruction slip should be from your own Demat account, not from any other family members'/friends' accounts.

- Do not sign blank delivery instruction slip(s) while meeting security payin obligation.

- No intermediary in the market can accept deposit assuring fixed returns. Hence do not give your money as deposit against assurances of returns.

- 'Portfolio Management Services' could be offered only by intermediaries having specific approval of SEBI for PMS. Hence, do not part your funds to unauthorized persons for Portfolio Management.

- Delivery Instruction Slip is a very valuable document. Do not leave signed blank delivery instruction slip with anyone. While meeting pay in obligation make sure that correct ID of authorised intermediary is filled in the Delivery Instruction Form.

- Be cautious while taking funding form authorised intermediaries as these transactions are not covered under Settlement Guarantee mechanisms of the exchange.

- Insist on execution of all orders under unique client code allotted to you. Do not accept trades executed under some other client code to your account.

- When you are authorising someone through 'Power of Attorney' for operation of your DP account, make sure that:
    - your authorization is in favour of registered intermediary only.
    - authorisation is only for limited purpose of debits and credits arising out of valid transactions executed through that intermediary only.
    - you verify DP statement periodically say every month/ fortnight to ensure that no unauthorised transactions have taken place in your account.
    - authorization given by you has been properly used for the purpose for which authorization has been given.
    - in case you find wrong entries please report in writing to the authorized intermediary.

- Don't accept unsigned/duplicate contract note.

- Don't accept contract note signed by any unauthorised person.

- Don't delay payment/deliveries of securities to broker.

- In the event of any discrepancies/disputes, please bring them to the notice of the broker immediately in writing (acknowledged by the broker) and ensure their prompt rectification.

- In case of sub-broker disputes, inform the main broker in writing about the dispute at the earliest and in any case not later than 6 months.

- If your broker/sub-broker does not resolve your complaints within a reasonable period (say within

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15 days), please bring it to the attention of the 'Investor Grievances Cell' of the NSE.

- While lodging a complaint with the 'Investor Grievances Cell' of the NSE, it is very important that you submit copies of all relevant documents like contract notes, proof of payments/delivery of shares etc. alongwith the complaint. Remember, in the absence of sufficient documents, resolution of complaints becomes difficult.

- Familiarise yourself with the rules, regulations and circulars issued by stock exchanges/SEBI before carrying out any transaction.

Products in the Secondary Markets

Following are the main financial products/instruments dealt in the Secondary market which may be divided broadly into Shares and Bonds:

Shares

Equity Shares: An equity share, commonly referred to as ordinary share, represents the form of fractional ownership in a business venture.

Rights Issue/ Rights Shares: The issue of new securities to existing shareholders at a ratio to those already held, at a price. For e.g. 2:3 rights issue at Rs. 125, would entitle a shareholder to receive 2 shares for every 3 shares held at a price of Rs. 125 per share.
Bonus Shares: Shares issued by the companies to their shareholders free of cost based on the number of shares the shareholder owns.

Preference shares: Owners of these 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 share. They also enjoy priority over the equity shareholders in payment of surplus. But in the event of liquidation, their claims rank below the claims of the company's creditors, bondholders/debenture holders.

Cumulative Preference Shares: A type of preference shares on which dividend accumulates if remained unpaid. All arrears of preference dividend have to be paid out before paying dividend on equity shares.

Cumulative Convertible Preference Shares: A type of preference shares where the dividend payable on the same accumulates, if not paid. After a specified date, these shares will be converted into equity capital of the company.

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Bond: is a negotiable certificate evidencing indebtedness. It is normally unsecured. A debt security is generally issued by a company, municipality or government agency. A bond investor lends money to the issuer and in exchange, the issuer promises to repay the loan amount on a specified maturity date. The issuer usually pays the bond holder periodic interest payments over the life of the loan. The various types of Bonds are as follows:

Zero Coupon Bond: Bond issued at a discount and repaid at a face value. No periodic interest is paid. The difference between the issue price and redemption price represents the return to the holder. The buyer of these bonds receives only one payment, at the maturity of the bond.

Convertible Bond: A bond giving the investor the option to convert the bond into equity at a fixed conversion price.

Treasury Bills: Short-term (up to one year) bearer discount security issued by government as a means of financing their cash requirements.

Equity Investment

When you buy a share of a company you become a shareholder in that company. Shares are also known as Equities. Equities have the potential to increase in value over time. It also provides your portfolio with the growth necessary to reach your long term investment goals. Research studies have proved that the equities have outperformed most other forms of investments in the long term. This may be illustrated with the help of following examples:

a) Over a 15 year period between 1990 to 2005, Nifty has given an annualised return of 17%.

b) Mr. Raju invests in Nifty on January 1, 2000 (index value 1592.90).

   The Nifty value as of end December 2005 was 2836.55. Holding this investment over this period Jan 2000 to Dec 2005 he gets a return of 78.07%. Investment in shares of ONGC Ltd for the same period gave a return of 465.86%, SBI 301.17% and Reliance 281.42%.

Therefore,

Equities are considered the most challenging and the rewarding, when compared to other investment options. Research studies have proved that investments in some shares with a longer tenure of investment have yielded far superio r returns than any other investment.

However, this does not mean all equity investments would guarantee similar high returns. Equities are high risk investments. One needs to study them carefully before investing.

Since 1990 till date, Indian stock market has returned about 17% to investors on an average in terms of increase in share prices or capital appreciation annually. Besides that on average stocks have paid 1.5% dividend annually. *Dividend* is a percentage of the face value of a share that a company returns to its shareholders from its annual profits. Compared to most other forms of investments, investing in equity shares offers the highest rate of return, if invested over a longer duration.

Factors that influence the price of a stock

Broadly there are two factors: (1) stock specific and (2) market specific. The stock-specific factor is related to people's expectations about the company, its future earnings capacity, financial health and management, level of technology and marketing skills.

The market specific factor is influenced by the investor's sentiment towards the stock market as a whole. This factor depends on the environment rather than the performance of any particular company. Events favourable to an economy, political or regulatory environment like high economic growth, friendly budget, stable government etc. can fuel euphoria in the investors, resulting in a boom in the market. On the other hand, unfavourable events like war, economic crisis, communal riots, minority government etc. depress the market irrespective of certain companies performing well. However, the effect of market-specific factor is generally short-term. Despite ups and downs, price of a stock in the long run gets stabilized based on the stock-specific factors. Therefore, a prudent advice to all investors is to analyse and invest and not speculate in shares.

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Growth Stocks

In the investment world we come across terms such as Growth stocks, Value stocks etc. Companies whose potential for growth in sales and earnings are excellent, are growing faster than other companies in the market or other stocks in the same industry are called the Growth Stocks. These companies usually pay little or no dividends and instead prefer to reinvest their profits in their business for further expansions.

Value Stocks

The task here is to look for stocks that have been overlooked by other investors and which may have a 'hidden value'. These companies may have been beaten down in price because of some bad event, or may be in an industry that's not fancied by most investors. However, even a company that has seen its stock price decline still has assets to its name - buildings, real estate, inventories, subsidiaries, and so on. Many of these assets still have value, yet that value may not be reflected in the stock's price. Value investors look to buy stocks that are undervalued, and then hold those stocks until the rest of the market realizes the real value of the company's assets. The value investors tend to purchase a company's stock usually based on relationships between the current market price of the company and certain business fundamentals. They like P/E ratio being below a certain absolute limit; dividend yields above a certain absolute limit; Total sales at a certain level relative to the company's market capitalization, or market value etc.

To buy equity stocks, one may subscribe to issues made by corporates in the primary market. In the primary market, resources are mobilised by the corporates through fresh public issues (IPOs) or through private placements. Alternately, you may purchase shares from the secondary market. To buy and sell securities you should approach a SEBI registered trading member (broker) of a recognized stock exchange.

Bid and Ask price

The 'Bid' is the buyer's price. It is this price that you need to know when you have to sell a stock. Bid is the rate/price at which there is a ready buyer for the stock, which you intend to sell.

The 'Ask' (or offer) is what you need to know when you're buying i.e. this is the rate/ price at which there is seller ready to sell his stock. The seller will sell his stock if he gets the quoted "Ask' price.

If an investor looks at a computer screen for a quote on the stock of say XYZ Ltd, it might look something like this:

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	Bid (Buy side)		Ask (Sell side)	
	Qty.	Price (Rs.)	Qty.	Price (Rs.)
	1000	50.25	2000	50.35
	500	50.10	1000	50.40
	550	50.05	1500	50.50
	2500	50.00	3000	50.55
	1300	49.85	1450	50.65
Total	5850		8950	

Here, on the left-hand side after the Bid quantity and price, whereas on the right hand side we find the Ask quantity and prices. The best Buy (Bid) order is the order with the highest price and therefore sits on the first line of the Bid side (1000 shares @ Rs. 50.25). The best Sell (Ask) order is the order with the lowest sell

price (2000 shares @ Rs. 50.35). The difference in the price of the best bid and ask is called as the Bid-Ask spread and often is an indicator of liquidity in a stock. The narrower the difference the more liquid or highly traded is the stock.

Portfolio

A Portfolio is a combination of different investment assets mixed and matched for the purpose of achieving an investor's goal(s). Items that are considered a part of your portfolio can include any asset you own-from shares, debentures, bonds, mutual fund units to items such as gold, art and even real estate etc. However, for most investors a portfolio has come to signify an investment in financial instruments like shares, debentures, fixed deposits, mutual fund units.

Diversification is a risk management technique that mixes a wide variety of investments within a portfolio. It is designed to minimize the impact of any one security on overall portfolio performance. Diversification is possibly the best way to reduce the risk in a portfolio.

A good investment portfolio is a mix of a wide range of asset class. Different securities perform differently at any point in time, so with a mix of asset types, your entire portfolio does not suffer the impact of a decline of any one security. When your stocks go down, you may still have the stability of the bonds in your portfolio. There have been all sorts of academic studies and formulas that demonstrate why diversification is important, but it's really just the simple practice of "not putting all your eggs in one basket." If you spread your investments across various types of assets and markets, you'll reduce the risk of your entire portfolio getting affected by the adverse returns of any single asset class.

DERIVATIVES

Types of Derivatives

Forwards: A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.

Futures: A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange-traded contracts, such as futures of the Nifty index.

Options: An Option is a contract which gives the right, but not an obligation, to buy or sell the underlying at a stated date and at a stated price. While a buyer of an option pays the premium and buys the right to exercise his option, the writer of an option is the one who receives the option premium and therefore obliged to sell/buy the asset if the buyer exercises it on him. Options are of two types - **Calls** and **Puts** options:

'***Calls'*** give the buyer the right but not the obligation to buy a given quantity of the underlying asset, at a given price on or before a given future date.

'***Puts***' give the buyer the right, but not the obligation to sell a given quantity of underlying asset at a given price on or before a given future date.

Warrants: Options generally have lives of up to one year. The majority of options traded on exchanges have maximum maturity of nine months. Longer dated options are called Warrants and are generally traded over-the-counter.

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At the time of buying an option contract, the buyer has to pay premium. The premium is the price for acquiring the right to buy or sell. It is price paid by the option buyer to the option seller for acquiring the right to buy or sell. Option premiums are always paid upfront.

COMMODITY EXCHANGE

A Commodity Exchange is an association, or a company of any other body corporate organizing futures trading in commodities. In a wider sense, it is taken to include any organized market place where trade is routed through one mechanism, allowing effective competition among buyers and among sellers – this would include auction-type exchanges, but not wholesale markets, where trade is localized, but effectively takes place through many non-related individual transactions between different permutations of buyers and sellers.

Definition of 'Commodity'

FCRA Forward Contracts (Regulation) Act, 1952 defines "goods" as "every kind of movable property other than actionable claims, money and securities". Futures' trading is organized in such goods or commodities as are permitted by the Central Government. At present, all goods and products of agricultural (including plantation), mineral and fossil origin are allowed for futures trading under the auspices of the commodity exchanges recognized under the FCRA.

Commodity derivatives market trade contracts for which the underlying asset is commodity. It can be an agricultural commodity like wheat, soybeans, rapeseed, cotton, etc or precious metals like gold, silver, etc.

The basic concept of a derivative contract remains the same whether the underlying happens to be a commodity or a financial asset. However there are some features which are very peculiar to commodity derivative markets. In the case of financial derivatives, most of these contracts are cash settled. Even in the case of physical settlement, financial assets are not bulky and do not need special facility for storage. Due to the bulky nature of the underlying assets, physical settlement in commodity derivatives creates the need for warehousing. Similarly, the concept of varying quality of asset does not really exist as far as financial underlyings are concerned. However in the case of commodities, the quality of the asset underlying a contract can vary at times.