HOW THE STOCK MARKET FUNCTIONS

THE STOCK EXCHANGE

BOMBAY
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No mystique about share investment

Share investment has no mystique. The uninitiated may be daunted by professional terms and jargon, trading methods and mechanics, and the privacy of membership, but only until these things are understood. Take a few facts.

Fact One. The stock exchange is a market place, like any other centralized market — vegetables, cattle or fish — where buyers and sellers do business in the most convenient and speediest way, at the fairest open prices. Unlike other markets, however, as the public is not admitted to the trading floor, business has to be done through registered brokers.

Fact Two. The stock exchange is open to anyone — big or small — with money to invest or securities to sell. One can start with as little as a few thousand rupees.

Fact Three. Prices of shares, like those of so many other things, fluctuate with supply and demand. They are influenced by a variety of factors — such as a company’s performance, prospects of a specific industry group, overall economic performance, and aggregate emotions of the investing public. This means that there is always some risk in share investment. The element of risk, however, can be minimized by knowledge, study, judgement, anticipate, or getting reliable advice.

Fact Four. Share investment offers a wide and varied choice. There is something for all types of investment needs and situations. There are around 3000 listed securities having a market value of Rs. 20,000 crores. While some of these are household names, others are relatively small and new. The stock exchange allows an individual to put his capital to work wherever he likes. His capital is also free to move from one enterprise to another — entitled to profits when the venture succeeds ready to stand losses if it fails.

Two-way Auction

A stock exchange is an auction market. But it is not like the conventional auction where buyers compete, and there is only one seller. In the stock exchange, there is a two-way auction. Bidders compete with each other to purchase at the lowest possible price the shares they want to buy. Simultaneously, those seeking to sell compete with each other to get the highest price for the shares they are offering. When the buyer bidding the highest price and the seller offering at the lowest price agree on a figure which is acceptable to each, a transaction is made.

The Bombay Stock Exchange, the oldest and the biggest of India’s stock exchanges was established nearly a century ago in 1875. It was followed by stock exchanges in other major cities such as Ahmedabad (1894), Calcutta (1908), Indore (1930), Madras (1937), Hyderabad (1943), Bangalore (1957) and Cochin (1979). In recent years new stock exchanges have been set up in Pune, Kanpur, Ludhiana, Rajkot and Gauhati.

Membership of a stock exchange is open only to individuals — companies are not eligible to become members.

The primary function of a member is to negotiate purchase and sale of securities in the stock market. A member can act in two capacities — as a broker buying or selling on behalf of his client for a commission, or as a dealer/jobber buying and selling on his own account.

There is a common belief that the stock exchange is a place where people indulge in speculation and try to reap quick profits. This is true only in parts. Because of the wide fluctuations in share prices, share markets are prone to speculation. No stock market can function efficiently without some speculation. Stock market owe their breadth and liquidity — both essential features for smooth functioning — to speculators. An excessive and undisciplined speculation, however, can lead to artificial price levels and payment defaults by operators. Such a situation can have a disastrous effect on stock markets. Therefore, to control the activities of the stock exchanges, the government has passed an Act, known as the Securities Contracts (Regulation) Act, 1956, which lays down the broad guidelines for the recognized stock exchanges. Using these as the basis, each stock exchange frames its bylaws, regulations and rules for the conduct of various functions relating to the sale and purchase of shares and other securities.

The highest authority of the stock exchange is the Governing Board. It consists of a majority of elected members along with a few nominees of the Government. The Governing Board is assisted in its day to day functioning by the administrative department of the exchange which is generally headed by an executive director. This department is responsible for functions such as processing applications from companies for listing, publication of daily quotations, fixation and realisation of margin money from members, reconciliation and clearing of business transactions, maintenance of security deposit by members, arbitration in matters of dispute and differences, and all other related functions.

The jargon is easy to understand

While the terms equity shares, debentures, preference shares, bonus, rights... may sound like technical mumbo-jumbo, their meanings and investment functions can be easily mastered after a little study.

A share signifies proportionate ownership of a company. If a company has issued 1,000,000 shares of Rs. 10 each, and if you buy 1000 shares of this company, 1/100th part of that company belongs to you including its plant and equipment, earnings and dividend, loans and losses. You also have a proportionate voice in the management of this company. As a proof of ownership, you will be given share certificates with your name recorded on it and the number of shares represented by the certificates clearly stated on it.

Thus, a share certificate is not just a piece of paper. To a company, it means capital. To an investor, it means a share of business. Shares have a fixed par value (also called nominal value or paid up value). In most cases this is...
Rs. 100 or Rs. 10 per share.

Shares (more accurately, equity shares) represent one type of security. (The terms stocks and scrips are also interchangeably used). Another kind of security is a debenture. It represents a promise by the company to pay back a loan, plus a certain amount of interest over a definite period of time. A third type — preference shares — stands between an equity share and a debenture in terms of a company’s obligation to pay dividend.

At times, companies stipulate that a debenture will be converted into equity shares as per a specified ratio at specified intervals. Such conversion could be optional or compulsory. The stipulation could be made at the time of issue, or at a later date.

Why do companies issue shares and debentures? They do so to raise money — or capital — to build new plants and to increase production. Thereby, they hope to increase profits. Part of these profits are paid to shareholders as dividend, and the balance are ploughed back into business. Companies earning consistently good profits and having a high plough-back build up reserves which they distribute in the form of bonus shares. These bonus shares also qualify for future dividend payouts.

New companies can invite the public to contribute initial capital in the form of shares or debentures through what is known as a prospectus. The prospectus is an important document which makes a detailed disclosure of all material facts about the company. If a company violates the terms of the prospectus — like non-payment of interest on debentures or non-issue of shares against convertible portion of debentures — what redress does the investor have?

In such cases the investor can request the stock exchange authorities who can take up the matter with the company. However, in many cases the stock exchange authorities are themselves helpless as the utmost they can do is to delist the shares issued by the company. Unfortunately, this will hurt the shareholders who will be deprived of a market for their shares. The other remedy available to the shareholder is to approach the Registrar of Companies.

After the initial issue, a company can raise additional capital by making a rights issue to existing shareholders, directors and business associates. At times a company may not be certain that the rights issue will be absorbed in full, and it may therefore offer such shares to new investors through registered brokers. It is also quite common for existing shareholders to renounce their rights in favour of new investors for a consideration. Prospective new investors should scrutinize such ‘offers’ of renunciation very closely before accepting them.

In recent years, new companies have used another method, called private placement, to raise capital from the public. The funds that are sought to be raised through private placement constitute that portion of capital which the promoters of the company are required to bring in as their own contribution before the company makes a public issue of capital. At one stage this unhealthy practice became very wide spread, and thousands of gullible investors were offered the bait of a firm allotment on a first come first served basis. More recently, however, a ban has been imposed that promoters’ shares cannot be sold for a period of three years. This has rightly discouraged new investors to subscribe to private placement, unless they are very confident of the promoters’ success.

What is the procedure by which shares are allotted in case of oversubscription?

Every application has an identification number running into six digits. These numbers are inverted and arranged in serial order after excluding multiple applications. They are then renumbered consecutively as 1, 2, 3 etc. This detailed working, done easily on a computer is presented to the stock exchange.

Government guidelines concerning allotments lay down that higher weightage should be given to small investors. The basis of allotment is worked out by the company and approved by the stock exchange. Thereafter lots are drawn. For example, if the allotment basis was one out of eight, and if the first lot drawn was serial number 7, serial number 7 will be the first allottee, and thereafter serial number 15, 23, 31 etc.

If for example, the family member of an investor makes 16 applications, it would appear that at least two applicants should get an allotment. However, the probability of no one getting an allotment cannot be statistically ruled out. All the applications having consecutive serial numbers would be scattered very widely when reversed.

Can a company delay allotment advice and refund orders?

As per the current law (Companies Act, Sec. 73, 2-A) companies are required to refund excess allotment money within 10 weeks from the date of closure of the subscription list. In case of failure, they are required to pay interest at 15% p.a. However, compliance with these provisions represents exceptions, and not the general rule. There have even been instances, when the posting of refund orders bearing the correct due date has been delayed by even two to three weeks.

Listing is essential for trading

A stock market is a place where securities can be bought or sold. However, it is wrong to presume that shares and debentures issued by any company can be freely purchased or sold on any stock exchange. Dealings in a particular stock market can take place only in those securities which are listed on it. A security is “listed” when it is added to the list of securities in which trading is permitted on that exchange.

There is no legal obligation on any public limited company to get its shares or debentures listed on a recognised stock exchange. However, there are situations which make it difficult for a widely held public limited company to avoid listing. For example, the controller of capital issues may require a company to get new issues of its shares or debentures listed. The financial institutions may lay down a similar condition while agreeing to subscribe or underwrite a new issue. Again, a company making a declaration in its prospectus that it intends to apply for the enlistment is required to make a listing application within a stipulated period. Moreover, a company wishing to raise money from the public will usually have its securities listed to create liquidity for the benefit of its investors.

For listing on a stock exchange, a company must be of a reasonable size — minimum issued capital of Rs. 50 lakh, of which at least Rs. 30 lakhs should be offered to the public.
A public limited company listed on any recognized stock exchange is obliged to comply with the undermentioned requirements:

— To notify the stock exchange about any forthcoming closure of books, at least 21 days in advance. The objective is to allow the investing public adequate time to lodge share certificates for transfer in favour of the new owner.

— To notify the stock exchange without delay of the date of the meeting of its board of directors at which any important recommendation — such as declaration of a dividend, or issue of rights or bonus shares or convertible debentures, or the skipping of dividend — is to be considered. This information is passed on to the members of the stock exchange — and through them to the investing public — so that equal opportunity is provided to everyone for buying or selling the shares of such companies. Likewise, the decision taken by a company’s board of directors in respect of the above also needs to be communicated to the stock exchange.

— To keep the stock exchanges informed of major events like strikes, lock-outs and closures which could affect the performance of a company.

— To return share certificates within two months of the date of lodgment of documents for transfer, subdivision, consolidation or endorsement. (Very few companies meet this deadline).

— To publish in a form prescribed by the stock exchange interim statements of its working. (Again; very few companies comply with this requirement).

Brokers and Jobbers

A stock exchange is a market for dealing in securities. However, the investing public is not permitted to enter the trading floor to do business. The investor must employ the services of a registered stockbroker for buying or selling of shares in a stock market. Also, it is important to know that brokers merely act as agents for their clients and deal with another class of stock exchange professionals called jobbers. The communication channel is as illustrated below.

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Client | Instruction to buy or sell | Broker | Execution of order | Jobber
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It will be observed that a client’s contact point is his broker, who charges a commission or brokerage — for his services. A jobber has no contact with the investing public — he deals only for his own account and profit.

The stock exchange does not recognize any party to a bargain in shares, other than its registered members. Your broker must therefore be a registered member. At times you may deal with a subbroker who must in turn transact business through a registered broker. The relationship between a broker and his clients is governed by the bye-laws of the concerned exchange, and also by the customs of the trade. For example, as a general rule, a broker is personally liable to third parties for acts done on behalf of his clients. However, if it becomes manifest that a client intends to default on his bargain, the broker need not wait for the client to actually default, but he can buy or sell other shares in the market and claim the difference.

A broker thus enjoys a right to indemnification from his client. Apart from this, he also has a right of lien in relation to the client’s property that has come into his hands. All securities and assets, including cash, held by a broker for his client is subject to the broker’s lien for any ‘on account’ balance or margin money including interest, commission, brokerage and other expenses that may be due to the client. Further, the broker is at liberty to sell, pledge, or borrow money against such securities and assets. He can not only reimburse himself from these, but he can also pay out any money payable by him on behalf of his clients.

What are the remedies available to a client if his broker defaults? The client, after a written notice to the broker, can close out contracts, within a reasonable period of the default, through any other member of the exchange. The defaulter must then pay to his client any loss or damage sustained consequent to his default. A client may also lodge a complaint with the Governing Board of the exchange. The Board would investigate the complaint and take suitable action against the broker. If in an extreme case, the broker is declared a defaulter, the Defaulter’s Committee of the Exchange would take charge of all his books of accounts and papers. It would also recover all money, securities and other assets of the defaulter and distribute them prorata among the creditor members. (Unfortunately, the claims of the clients will be entertained last).

A client may also seek redress in civil or criminal courts against a defaulter broker. This, however, is a time consuming and expensive procedure which is best avoided.

Jobber — Taravaniwallas

Jobbers specialise in one or more listed securities. By trading in and out of the market for a small difference in price, they help in maintaining a liquid and continuous market in the stocks they specialise in. For active shares, there may be several jobbers trading in them. On the other hand, for inactive shares, only one jobber may be doing the dealing in many of them.

In order that the brokers and the authorized clerks can readily locate the jobbers dealing in individual securities, trading takes place at the spot where the security is posted. Thus, the floor of the exchange is roughly divided into a series of smaller markets for the government securities, debentures, non-specified shares and specified shares, and each of these markets is further divided into submarkets for one or more securities.

Jobbers specialise in some counters, i.e. a place where particular shares are traded. Even at one counter, there may be more than one jobber and the prices quoted by them may differ according to their individual judgements. All jobbers however, try to keep their books clean at the end of the day. It means that whatever they purchase is sold by them, and whatever they have sold earlier is purchased by them. They would not keep any outstanding business to be carried forward to the next day.

Jobbers spread

Normally when a broker approaches a jobber, he will be quoted two prices. The higher price (offer) represents the figure at which the jobber will sell. The lower price (bid) represents the price at which he will buy. The difference in those two prices is the jobbers spread. For a share which is
not very active and there is only one jobber, the concerned jobber is not faced with any competition, and therefore his spread can be large.

The concept of jobbers spread can best be explained by considering an illustration. Assume you have given your broker an order to buy 100 equity shares of company X at not more than Rs. 220 a share. Upon receiving your order, your broker or one of his authorized clerks (each broker is allowed to have about half a dozen authorized clerks) goes to that part of the trading floor where jobbers in company X are to be found. Approaching one of them, he shouts "What price X?" or simply "X". Note that he will not disclose whether he wants to buy or sell; he will just ask for a quotation.

The jobber could reply "218-220", or for brevity simply "18-20". This means that he is prepared to buy at Rs. 218 and sell at Rs. 220. The difference between the two quotations is called the "jobber's spread", and represents the profit the jobber hopes to make if the deal goes through.

On getting a quotation of "218-220" from the jobber, your broker has three options. Since he was asked to purchase at a price of Rs. 220 maximum, he may accept the offer and complete the deal. Alternatively, he may approach another jobber to find out if he quotes anything less. If 'X' is an actively traded and popular share, it will not be difficult for the broker to locate another jobber, who may quote slightly differently, say "217-219" or "21.5-219.5". The third option the broker can exercise is to make a counterbid himself, say buy at "218.5". If he fails to get a response, he may raise his bid to 219. At this stage a jobber who perhaps had already purchased 100 shares of X at 218, finds the offer attractive and coming forward shouts "Sold 100 X at 219". The broker shouts in return "Bought 100 X at 219", and the deal is struck.

The broker and the jobber will then make pencilled notes in their books. No documents are exchanged at this stage and the deal is concluded only on the basis of the spoken word. At the end of the day however, the brokers and the jobbers will check their entries to find out if there had been any mistakes due to the rush of business, and settle them amicably.

Price of actively traded shares change almost from minute to minute depending upon demand and supply. If there are more buyers than sellers, jobbers will raise prices to attract sellers and discourage buyers. The process will be reversed if sellers outnumber buyers. The objective of every jobber will normally be to balance his purchases and sales. Every time a jobber deals with a broker, he knows how much stock he has on his books, and the prices at which different lots have been purchased. Therefore, he always quotes a price which will enable him to neutralize his outstanding purchases or sales, and eventually leave him a small profit.

Jobbers ensure liquidity for the shares in which they trade, by constantly purchasing and selling them. The two-way prices which they quote is the source of their profit. However, it is not always necessary that a jobber would have earned profit at the end of a day. It is possible that, even if a jobber is careful to keep a spread between the buying and selling prices, the ruling price may move below the price at which he had bought the shares. In that case he will suffer a loss.

Readers will observe that a jobber is performing a crucial function — he is helping to make an active and con-

- continuous market in the shares in which he specializes. He stands in the ring, always ready to buy or sell. It is through a jobber that the law of supply and demand finds an expression in share prices.

- The jobber's spread is generally a fraction of a percent for actively traded shares. However, if a share is traded very infrequently, a jobber will try to maintain a large spread to cover the risk of its books not being balanced. In some cases the spread could be 5 to 7% of price. It is therefore advisable that, other things being equal, investors should prefer active shares so that their transaction costs do not have a large element of jobber's spread.

In the more developed stock markets of the West, a jobber is required to follow strict guidelines about his spread. He cannot refuse to buy or sell a share, and the spread cannot be increased steeply from one transaction to the next. Stock exchange authorities maintain record of each jobber's performance, and this is used as the basis for appointment of jobbers for newly listed companies. These regulations and self disciplinatory measures help make a continuous and orderly market. Unfortunately, however, in India the operations of jobbers are not yet adequately regulated, and it is not uncommon for jobbers to refuse to buy or sell, or to quote very large spreads.

In the financial newspapers which print daily share prices, a typical entry on a particular day might be XYZ (101, 102, 104). The entry in parentheses (101) refers to the closing price on the previous day. If your broker bought shares of XYZ for you at 104, you might get the impression that he bought at the peak of the market, and did not get you a good bargain. This is not necessarily so. It is quite possible that as soon as trading started the jobber's quote was "101-103" and the first transaction was a sale to the jobber at 101. At that time your broker may not have been around to buy at 103. Later, the jobber may have realized that he was oversold, that is, he had too many sales uncoupled on his books. Therefore, in order to attract more sellers, he could have raised his bid to "102-104". Again, it is possible that the second transaction at mid session was also a purchase by the jobber at 102, and only the last transaction toward the end of the session was a sale by the jobber to your broker at 104. In such a situation, your broker could have got you a better deal than buying at 104, because throughout most of the session, that was the only price at which the jobber was willing to sell.

It is very important for investors to understand the reality of jobber's spread, over which their brokers have no control. A lack of its understanding has caused many mis-

- understandings between clients and their brokers, and often diluted the mutual trust between them.

Rate Recording

- How do the newspapers get the information on share prices which they publish daily? These are reproduced from a daily quotation list issued by the stock exchange. The list itself is completed by recording clerks. These clerks are employees of the exchange who go around to obtain the rates from jobbers. Under such a system of reporting, occasional inaccuracies — intended or otherwise — cannot be ruled out.

- The stockbrokers themselves report their transaction rates to exchange authorities in statements prepared for the computer. For reasons of expediency, it has not yet been possible to use these rates for reporting to the press.
Types of bargains: Bargains on the exchange are settled by payment and delivery, or vice versa. As per the bye-laws and regulations, the bargains may be of the following types:

1) For “Spot delivery” that is, for delivery and payment on the same day as the date of the contract, or the next day.

2) For “Hand delivery”, that is, for delivery and payment within the time or the date stipulated while entering into the bargain which time or date shall not be more than 14 days following the date of the contract.

3) For “Special delivery”, that is, for delivery and payment within any time exceeding 14 days following the date of the contract as may be stipulated when entering into the bargain, and permitted by the Governing Board or the President; and

4) For “The Clearing”, that is, for clearance and settlement through Clearing House in the manner prescribed by the bye-laws and regulations.

All the listed securities of a stock exchange are classified either as specified securities (also called cleared securities or ‘A’ group securities), or as non-specified securities (also called cash securities or ‘B’ group securities). The Governing Board has the power to notify from time to time the securities which shall be included in the specified or non-specified list.

Bargains for spot delivery, hand delivery, and special delivery can be made in any security in which dealings are permitted on the exchange. Bargains for clearing, however, are allowed to be made only in specified securities.

The Governing Board fixes in advance the first and the last business day for each clearing (also called settlement). Thus the stock exchange calendar is divided into about 25 settlements — settlement No. 1, settlement No. 2, etc. of about two weeks duration each.

Making up price (Badla Rate)

At the end of a settlement period a broker has three options:

1. Terminate his contract of sale or purchase by a cross contract.
2. Complete the contract by delivery or payment, as the case may be.
3. Carry-over the contract to subsequent settlement.

The first two options are straightforward. Under the third option, if members have to settle the accounts individually, confusion is likely to arise in view of the multiplicity of transactions which the member would have entered into at varying prices. Therefore, for the purpose of working out the liabilities between members in respect of unfulfilled contracts the exchange gives a rate known as the “making-up” price at which the contracts are settled for the current settlement, and are carried over to the next settlement. This price is fixed generally in relation to the closing price of the share on the last working day.

Carrying forward of transactions enables an operator to defer cash flows. Suppose an operator purchases 1000 shares of company X at Rs. 50 each and finds that at the end of the account the price has risen to Rs. 51.50. If he sells, and pays brokerage at the rate of 50 paisa a share, he will still be left a profit of Rs. 1000. The operator may, however, feel that the price of his shares may rise further and he can make a bigger profit by waiting or holding out. If, however, he has no money to pay for his purchase, he can arrange with his broker to carry forward his business to the next settlement account. This will defer his cash outflow by another fortnight. His broker would then find someone who will receive the shares on his behalf and pay for them on the due date. (Called pay-in day).

Contango charges

The financier who advances the needed funds will charge interest (or contango in stockmarket parlance) for the fortnight till the next pay-in day. The rate of interest or the contango charge depends on many factors, including the state of the money market, that is, whether money is cheap or dear, and whether the market is over bought or over sold.

Special sessions are held by the stock exchange at the end of each account to determine the contango (badla) charges for individual shares in the specified list in actual biddings. The charges are never fixed except in exceptional circumstances by the stock exchange, and fluctuate just like share prices on the basis of demand and supply of money.

Bulls and Bears

The operator in the above illustration, who expects the share prices to rise, is called a bull. His opposite is called a bear. A bear is an operator who expects prices to decline and sells shares which he may not own. His intention is to buy those shares at a later date, when the prices do decline, and then square up the transaction with a profit. This activity is generally referred to as selling short.

If a bear operator wants to carry forward his transaction from one settlement to the next he must find someone who will loan to him the shares which he has to deliver on the settlement day. Alternatively, he can find a bull operator who cannot pay for his purchase and wants his business also to be carried forward.

Normally, a bear does not have to pay interest on his business carried forward. On the contrary, he receives a payment identical to that paid by the bull operator. This is because a bull, who has purchased shares but cannot pay for them, is glad to pay a small charge to a bear who has sold shares but cannot deliver them.

At times, however, the seller (bear) who normally gets paid contango on his sales, may have to pay the buyer a charge called “backwardation” or “undhabadha”. This happens when the shares are oversold, and the buyers are in a demanding position.

Financiers or Badliwalas

Those lend money to those who wish to carry forward their purchases from one account to the next. They also lend securities to those who do not wish to square up their transactions at the time of the fortnightly settlement.

Margin requirements

Carrying forward of transactions could lead to excessive speculation which the stock exchange authorities try to regulate by asking the operators to deposit margin money.
Such margins could be varied both in magnitude and in periodicity, depending upon the magnitude of speculative activity. They could be imposed on bulls, or bears, or both.

Non-specified shares

Transactions in non-specified shares are for compulsory delivery. Normally settlement date is fixed once a fortnight, but it is not unusual to have 3 to 4 weeks interval between two settlement dates. Moreover, though the clearing house may issue delivery orders for all transactions of sales and purchases executed during the previous settlement, some seller brokers do not deliver—or are unable to deliver—shares against their sales. Unlike shares in the specified list, undelivered shares are carried forward at the transacted price without any badla charges. Some seller broker could be collecting bada charges privately for withholding the delivery of actively traded non-specified shares. The buyer broker in such situations is helpless in giving delivery of shares to his clients. The only recourse available to him is to seek an auction notice against the seller, and claim the difference between the contract price and the auction price. This procedure is rather cumbersome and causes unpleasantness between brokers. Hence it is employed only in extreme cases.

How to place an order

A client has two options when instructing his broker to transact business. He may tell him to buy or sell “at best rate”, and leave the matter to his judgement; or he may specify reasonable price limits. For example, in the illustration given above, the client could have specified “Buy at 102 maximum.” In such a situation, however, the broker would have been unable to execute the order, even though the next morning’s papers would have quoted the rates as 101, 102, 104. Too strict an adherence to limits can result in a good opportunity being missed, specially when the market is changing rapidly.

In a bull market it is advisable to avoid strict buying limits if you want to ensure a purchase, otherwise you could be trailing a share for days together without actually buying it. Likewise, in a bear market it is advisable to place selling orders at “market rates”. If you specify a selling limit and the markets slide down, you would have lost an opportunity to sell your stock that day—and the next day could be lower still.

Whenever specifying limits, it is necessary to state whether the limits are “net”, that is, inclusive of the broker’s commission, or “at market”, in which case the broker’s commission will have to be added to the price.

Cum or ex

Another important point to be noted is that share prices are sometimes quoted cum or ex dividend, bonus or rights. For the sake of brevity these are written ‘cd’, ‘cb’ or ‘cr’ if cum, and ‘xd’ ‘xb’ or ‘xr’ if ex. Unless specifically mentioned, all prices are ‘cum’ which means that all future dividends, bonuses and rights will accrue to the buyer. In case of doubt—which could arise if trading date is close to the date on which a share changes status from ‘cum’ to ‘ex’—it is always advisable to clarify the doubt with the broker before placing an order with him.

If shares are purchased when they are quoted ‘cum’, and sent for registration before the closure of books, dividends and other distributions are made to the new purchaser who will henceforth be the registered holder of the shares. But what happens if the books are already closed? Does the buyer lose the distributions? Fortunately, the answer is NO. In such a situation, it is the responsibility of your broker to collect the distributions (dividends, bonus or rights) from the previous seller in your favour.

Contract Note

After a broker has executed a client’s order, he formalises the transaction by issuing a contract note or simply contract to the client. This note is in a prescribed form, and confirms that a certain number of securities have been bought (or sold) at the stated price by your order and to your account. This note is the most important evidence of the transaction. Once delivered and accepted, it binds the client as well as the broker, and neither can repudiate the contract. A good broker ensures that the contract note is sent to the client by hand delivery or by post (usually under certificate of posting) on the same or the next day of transaction. If this is not feasible, it is advisable for the broker and the client to agree on a mutually acceptable mechanism (e.g. telephone call) for confirmation of a transaction.

Settlement periods

As mentioned earlier, in order to avoid settlement of too many transactions on a day to day basis, the stock exchange year is divided into periods called “account”. An account normally runs for a fortnight but at times it may be of a bigger duration of three to four weeks. All transactions made during one account are to be settled either by payment (for purchases) or by delivery (of share certificates sold) on notified days which are made known to the members of the exchange through a clearing programme.

The two most important dates covered in the programme are pay-in and pay-out. Pay-in day is the day on which the broker has to make payment to the clearing house for all purchases made by him in the previous settlement period. The broker will normally expect to receive payment from his clients a few days before the pay-in date, to allow for bank clearing and other paper work. The pay-out date is the date on which the broker receives payment for sales made and valid share certificates delivered to the clearing house. Again, it will take the broker two to three days after the pay-out date to remit the sales proceeds to the concerned client.

Very often clients have an impression that their brokers collect payment in advance for purchases, but delay remittance of sales proceeds. While such an impression may be correct in some cases, in others there could be valid explanations.

For example, when a new client makes a purchase, the broker may collect from him payment—in full or in part—to cover the risk of the client backing out from the purchase contract. In case the market goes down. Later, it may so transpire that the broker does not receive delivery of the concerned share certificates from the stock market on the due date. In such a situation, the investor has a genuine grievance over which, unfortunately, the broker has little control.

Likewise, when a client has made a sale and despatched the concerned share certificates, he expects the sale
proceeds within a reasonable time. If everything goes all-
right, he should receive his payment within 2 to 4 weeks of
the sale, depending on whether the sales order was ex-
cuted at the beginning or at the end of the concerned settle-
ment account. While there could be instances of a broker
deliberately delaying remittance of sale proceeds to his
clients, there could also be valid reasons for the delay. For
example, if the share certificates were received by the broker
one day after the date which had been fixed by the
stock exchange for delivery the opportunity of receiving
payment on the due pay-out date would have been missed.
The delivery would then have to be affected in the next
settlement, and this would delay receipt of payment by the
broker. Remittance to the client will also be correspond-
ingly delayed.

Very often, it also happens that the share certificates
despatched by the client are found deficient and cannot
be delivered to the stock exchange. There could be a
number of reasons for this — the certificates are not in
marketable lot and have to be sert to the company for
splitting or consolidation; the certificates have not been
endorsed for call moneys paid after the initial issues; or
there has been a change in the nominal value of the shares
(e.g. from Rs. 100 paid up to Rs. 10 paid up) and the certifi-
cates sent by the client relate to the old value; or the
company’s name has changed. In such cases, the broker
will send the certificates to the concerned company for
necessary action, and tender these in the stock exchange
only after they are received from the company. The remitt-
ance of the sales proceeds will correspondingly be
delayed.

Odd lots and marketable lots

Trading in equity shares on stock exchanges in India is
mostly confined to marketable lots. For shares having a
paid up value of Rs. 10; marketable lot is generally fifty
shares, and for share of Rs. 100 paid up value, the market-
able lot is generally five shares. However, there are many
exceptions to this generalization (see page 87).

Marketable lots of shares of an actively traded com-
pany can be bought or sold easily in the stock markets
through recognised stock brokers. However, problems
arise when one wants to buy or sell shares in lots which are
different from their marketable lots. In stock markets, such
lots are called odd lots. If a marketable lot of a share is 100,
a single share certificate of a different denomination —
either smaller (e.g. 40 50 shares) or even bigger (e.g.
example 500 shares) — will be considered an odd lot.
Purchase and sell of odd lots is usually very difficult. Also,
the price quotation for an odd lot could differ by as much
as 5-15% from the price quoted for a marketable lot.

Odd lots generally arise from issue of bonus or right
shares. Sometimes however, a company may issue share
certificates in odd lots even at the time of initial allotment.
This may be expedient for the company, but it causes
considerable inconvenience and loss of liquidity for the
investor.

Various schemes are being considered by different
authorities to assist investors in trading odd lots. None of
these, however, has so far proved satisfactory.

Share transfer rules permit combining of share certifi-
cates to constitute a marketable lot, provided all the own-
ers of each certificate are the same and their names ap-
pear in the identical sequence. All such certificates con-
stituting a marketable lot can be attached to the same
transfer deed. Further, if two transfer deeds submitted
together make a marketable lot, the delivery will be con-
sidered acceptable.

Transfer Deed: The Biggest Hurdle

When you buy shares of a company, the seller will
deliver through your broker the concerned share certifi-
cates accompanied by prescribed share transfer forms.
These are to be filled in by the buyer and sent to the
concerned company along with the share certificates for
transfer in the buyer’s favour.

Transfer of shares and debentures requires compliance
with certain conditions as follows:

1. There should be a proper instrument of transfer.
2. The instrument should be duly stamped.
3. It should be executed by, or on behalf of, both the
   transferor and the transferee.
4. It should contain the name, address and occupation of
   the transferee.
5. It should be delivered to the company along with the
   relevant share certificates.

The transfer procedure is perhaps the biggest hurdle in
share investment. The validity period of the transfer deed,
which has to be date-stamped by the prescribed authority,
is limited. This creates many problems for the brokers and
the clients. Large funds get blocked if transfer forms become
outdated. The problem gets aggravated if there is delay by
the company or its transfer agents in the transfer of shares
beyond the stipulated two-month period. As a result, in-
vestors who have paid money to their brokers for purchase
of shares, may not receive share certificates for many
months in some cases.

In recent years, volume of business in stock markets has
increased very sharply. Typically, an active scrip in the
stock market may get 40 to 50,000 transfers involving four
to five lakh shares at the time of closure of books. A listed
company is required to give notice to the stock exchange
about the closure of its books five weeks in advance.
However, the stock exchange procedure is such that after
delivery of the transfer deeds, the broker hardly gets a week
to obtain the signature of the transferees, and lodge them
with the company. It is therefore not surprising that the bulk
of the transfers are lodged only during the last three or four
days prior to the closure.

The processing of transfer involves the following steps:

1. Scrutiny of the transfer deed to ensure that it is duly ex-
cuted and stamped.
2. Verification of the signature of the transferor against the
   specimen signature lodged with the company.
3. Debiting of the shares/debentures to the transferor’s
   account.
4. Finding out if the transferee has an existing account, or
   creation of a new folio account for him.
5. Crediting of shares/debentures to the account of the
   transferee.
6. Endorsement and despatch of certificates to the
   transferee.
A major hurdle in share transfers is verification of signatures. Nearly 10% of transfer deeds come under objection that the signature on the transfer deed differs from the signature lodged with the company. It has been suggested that a company should be able to accept a signature if it has been attested by a bank or a registered stockbroker.

There is no provision in the transfer deed for the buyer to indicate his existing folio account number, if any. Enormous resources are required to identify whether the buyer is an existing shareholder or not. Perhaps the transfer deed can be suitably amended for this purpose.

The Bombay Stock Exchange has suggested the creation of a stock-holding corporation which will dispense with both the transfer deed and the share certificates. As things stand today, a large number of share certificates and transfer deeds are blocking the system everywhere — from printing presses to share departments to post offices to the stock exchanges.

When a company refuses to transfer the share certificates on the basis of the transfer deeds presented to it, the deed becomes a defective document. Under the bye-laws of the recognized stock exchanges, the broker who first introduced the deed in the market is obliged to remove the defect. If a client is stuck with shares having defective transfer deeds, he should approach his broker for getting the defect removed.

Transferability of shares

Under the current law (Sec. 22-A of the Securities Contracts (Regulation) Act enacted in 1955), there are only four grounds (and no more) on which a company's board of directors can refuse transfer of listed shares. These are:

1. Transfer deed is defective or deficient.
2. Transfer is in contravention of any law.
3. Transfer is likely to result in a change in the composition of the board of directors which could be prejudicial to the interest of the company or to the public interest.
4. Transfer is prohibited by any order of any court, tribunal or other authority under any law.

If a company refuses transfer on grounds of defective or deficient transfer deed, both the transferor and the transferee are to be notified. If the objection is on any of the other three grounds, a reference has to be made to the Company Law Board with copies to the transferor and the transferee. The order passed by the Company Law Board, after hearing all the concerned parties, is final and binding.

Transfer Stamps:

Under the provision of the Indian Stamp Act, the transfer deed for transfer of shares is required to be stamped at the rate of 50 paise per Rs. 100 or part thereof, calculated on the amount of consideration. However, in case of transfer of debentures, the stamp duty is required to be affixed at the prescribed rates — as in force in different states — calculated on the face value of the debentures and not on the amount of consideration.

(Reproduced from Aridhi’s Investment Diary)
STOCK MARKET GLOSSARY

Arbitrage: The business of taking advantage of difference in price of a security traded on two or more stock exchanges, by buying in one and selling in other (or vice versa).

Arbitration: Settlement of claims, differences or disputes between members, clients, authorized clerks, subbrokers and employees, through appointed arbitrators. A party dissatisfied with the award of the arbitrators is allowed to appeal to the arbitration committee.

At best: An instruction from the client to the broker authorizing him to use his discretion and try to execute an order at the best possible price. An 'at best' order is valid only for the day it is placed.

Averaging: The process of gradually buying more and more securities in a declining market (or selling in a rising market) in order to level out the purchase (or sales) price.

Bargain: Transaction between two members of the same exchange. The terms ‘deals’ and ‘contracts’ also have identical meanings.

Bear: An individual who expects the prices to go down.

Bear Market: A weak or falling market characterised by absence of buyers.

Bull Market: A rising market with abundance of buyers and very few sellers.

Badla: Carrying forward of transaction from one settlement period to the next without affecting delivery or payment. This is permitted only in specified securities and is done at the make up prices fixed by the exchange.

Normally the make-up price is the closing price of the last day of settlement, but in exceptional circumstances the board may use its discretion and specify a different make-up price.

A Badla transaction, however, attracts payment of ‘margin money’ specified by the board from time to time.

Besides the buyer pays (and the seller receives) contango or Badla Charges (interest charges) at rates determined in the trading ring based on demand and supply. The facility of carrying forward a transaction provides liquidity to the market.

Backwardation: ‘Ulta Badli’ or ‘Unaura Badli’. Payment made by a seller to a buyer for the loan of securities for which the seller wishes to defer delivery.

Book Closure: Dates between which a company keeps its register of members closed for updating prior to payment of dividends or issue of new shares. A transfer deed date stamped prior to books closure but lodged with the company after the books closure is considered invalid.

Blue Chips: Shares of well established profitable companies enjoying high investment status.

Bonus: A free allotment of shares made in proportion to existing shares out of accumulated reserves. A bonus share does not constitute additional wealth to shareholders. It merely signifies recapitalization of reserves into equity capital. However, the expectation of bonus shares has a bullish impact on market sentiment and causes share prices to go up.

Cum: Means ‘with’. A cum price includes the right to any recently declared dividend (cd) or right share (cr) or bonus share (cb).

Clearing Days: Or settlement days. Dates fixed in advance by the exchange for the first and last business day of each clearing. The intervening period is called settlement period which is normally two weeks.

Cash Settlement: Payment for transactions on the due date as distinct from carry forward (badla) from one settlement period to the next.

Clearing House: Each exchange maintains a clearing house to act as the central agency for affecting delivery and settlement of contracts between all members. The days on which members pay or receive the amounts due to them are called ‘pay-in’ or ‘pay-out’ days respectively.

Cleared Securities: For the purpose of trading, a security is categorised either as cleared security (also called specified security) or as a non-cleared security (also called cash security). For securities in the cleared list, delivery and settlement is done only through the stock exchange clearing house. A security is classified as specified or non-specified by the Governing Board of the concerned stock exchange.

Contango: Consideration or interest charges paid to seller for carrying over a transaction from one settlement to the next.

Crisis: Reckless heavy short-sales leading to unduly depressed prices. In such a situation, the Board may prohibit short sales, fix minimum prices below which sales or purchases are not permitted, and limit further dealings only to closing out of existing contracts.

Correction: Temporary reversal of trend in share prices. This could be a reaction (a decrease following a consistent rise in prices) or a rally (an increase following a consistent fall in prices).

Delivery: A transaction may be for a ‘spot delivery’ (i.e. delivery and payment on same or next day), ‘hand-delivery’ (i.e. delivery and payment on the date stipulated by the Exchange, normally within two weeks of the contract date); Special delivery, (delivery and payment beyond fourteen days limit subject to the exact date being specified at the time of contract and authorized by the Exchange) or ‘clearing’ (clearance and settlement through the clearing house).

Ex: Mourn without. A price so quoted excludes recently declared dividend rights or bonus share.

Floating Stock: That fraction of the paid up equity capital of a company which normally participates in day-to-day trading. On an average, about 30% of equity capital is held by promoters; another 30% by financial institutions and the balance 40% by the public, mostly for long term investment. Consequently the floating stock of a company rarely exceeds 15-20% of its equity capital. Low floating stock causes erratic price movement as in the case of securities in the non-specified list.

Governing Board: A stock exchange functions under the
direction and supervision of its Governing Board. It generally consists of a specified number of elected members, a whole time executive director and representatives of the public and/or Government. The size and structure of the Board varies from exchange to exchange.

Jobbers: Member brokers of a stock exchange who specialise in buying and selling of specific securities from and to fellow members. Jobbers do not have any direct contact with the public, but they serve a useful function of imparting liquidity to the market.

Jobbers Spread: The difference between the price at which a jobber is prepared to sell and the price at which he is prepared to buy. A large difference reflects an imbalance between supply and demand.

Kerb Dealings: ‘Khargi Bhau’or ‘Band ke Bhau’. Transactions done between members after the official close of the trading hours.

Limit Orders: Instructions to the broker limiting him to buying at a stated maximum price or to selling at a stated minimum price.

Listed Company: A public limited company which satisfies certain listing conditions and signs a listing agreement with the stock exchange for trading in its securities. One important listing condition is that a major portion of its issued capital should be offered to the public.

Long Position: A built position in a security.

Make Up Prices: Prices fixed by the stock exchange to facilitate settlement of bargains in specified securities, particularly at the end of a settlement period.

Moort: Auspicious trading on Diwali day during specified hours.

Members: A stock exchange does not recognize transaction between parties other than its own members also called stock brokers. Every member is directly and primarily liable to every other member with whom he does a transaction, for its due fulfilment. The transaction could be for his own account or for the account of his principal (or client). Each member is allotted a clearing number to facilitate delivery and settlement through the clearing house.

Pari Passu: A term used to describe new issues of securities which have the same rights as similar issues already in existence.

Right Issue: The issue of new shares to existing shareholders in a fixed ratio to those already held at a price which is generally below the market price of the old shares.

Settlement Period: For administrative convenience, a stock exchange divides the year into a number of settlement periods each of two to three weeks duration. The first and the last day of each settlement period are fixed in advance: so are the settlement days for delivery and payment.

Selling Short: Normally one buys a security first and then sells it later. This is described as going long, and is profitable in rising markets. The reverse process—selling a security first, and then buying it later, is called selling short. This is profitable in a declining market.

Stamp Duty: The ad valorem duty of ½% payable by buyer for transfer of shares in his name.

Unit Of Trading: The minimum number of shares of a company which are accepted for normal trading on the stock exchange. All transactions are generally done in multiples of trading units. Odd-lots can be traded only at a slight discount.

Volume Of Trading: The total number of shares which change hands in a particular company’s securities. This information is useful in explaining and interpreting fluctuations in share prices.

(Reproduced from Aridhi’s Investment Diary)
Allotment Letters: - Documents issued evidencing allotment or distribution of shares in response to applications for them or in pursuance of contracts entered into in that connection.

Bear: - An operator who first sells and then buys shares.

Bearer Securities: - Securities which do not require registration of the owner's name in the Company's books.

Bid: - An offer of a price to buy or sell as in an auction. Business on the Stock Exchange is done by bids.

Blue Chips: - Stocks of high investment quality usually of well-reputed companies.

Bonus Shares: - When a company distributes shares to its shareholders free of cost, by capitalization of reserves, such shares are called "bonus shares".

Book-Closing: - The closure of the books of a company to take a record of the shareholders who are entitled to dividends or rights etc. No transfer is registered during the book-closing period.

Break-up Value of Shares: - Net assets as shown in a company's Balance Sheet divided by the number of shares.

Boom: - Boom denotes increased activity in a market arising out of greater demand.

Bull: - An operator who first buys, and then sells shares.

Buying-in: - When a seller fails to deliver shares to a buyer on the stipulated date, the buyer can enforce delivery by "buying-in" against the seller.

Bad Delivery: - A delivery of shares in pursuance of a transaction is considered "bad" when there is any defect in share certificate or transfer deed.

Delivery: - Presentation of certificate of shares with transfer deeds in fulfilment of a transaction.

Discount: - When a security is quoted at a price below its nominal or face value, it is said to be at a discount.

Ex-Dividend: - A term to indicate that the buyer does not get the current dividend.

Ex-Rights: - Implies that the shares bought are without the right to subscribe to the additional shares currently offered by the company.

Face-Value: - The value as appears on the face of the scrip. scrip. Same as nominal or par value.

Floor: - Trading Hall of the Stock Exchange.

Gilt-edged: - Securities issued by the Government.

Gross: - When used in connection with dividend or interest implies amount without any deduction of tax etc.

Growth Stock: - Stock of a company with prospect for future growth.

Guaranteed Stock: - Stocks which are guaranteed by a party other than the issuer, as to dividend, interest or principal.

Interalia: - Among other things.
Call:– The instalment of the
the capital of a company, which
a shareholder is called upon to
pay.

Clearing:– Settlement or
clearance of accounts in a Stock
Exchange.

Contributory:– The person
who is required to contribute to
the uncalled part of the shares
of a company in the event of
winding-up.

Convertible:– Securities
which are capable of being con-
verted into another category
(frequently into ordinary
shares) in accordance with the
terms of the issue.

Coupon:– Tokens for
payments of interest attached
to bearer securities.

Cover:– Buying of security
previously sold short.

Cum-Dividend:– Implies
that the buyer gets the current
dividend.

Cumulative Preference Share:–
In such share dividends accumu-
late if not paid and have to be
paid out before paying dividend
on Ordinary Share.

Debentures:– Bonds issued by
a company bearing a fixed rate of
interest and repayable on a
particular date.

Official List:– The list
containing names of securities
allowed to be transacted on the
Stock Exchange by the Committee.

Paper Profit:– Unrealized
profit on a share.

Par Value:– Means the face
value of securities.

Letter of Renunciation:– A
document which is sent with a
letter of allotment, by signing
which the allottee can renounce
his right to the allotment in
favour of other persons.

Letter of Right:– A document
which is sent to a shareholder
offering him the right to subscribe
to a specified number of shares.

Liquidation:– The process of
converting stocks into cash. Also
means dissolution of a company.

Making-up Price:– The price
at which shares are closed for the
current settlement and carried
over the next settlement day.

Margin:– An advance payment
of a portion of the value of a
stock.

Market Price:– The price at
which a stock can be bought in the
market, as against its par value.

Maturity:– The date on which
a security is paid off.

Net-Dividend:– Dividend after
deduction of tax payable from the
gross dividend.

New Issue:– Shares sold by a
company for the first time.

Non-Cumulative:– Implies that
arrears of dividends will not
accrue.

Redemption Price:– The price
at which a bond is redeemed.

Registered Bond:– A bond which
is registered in the books of the
company in the name of the owner.

Right Shares:– Additional
shares which a company offers
pro-rata to its existing share-
holders.
Pari Passu: Means in equal proportion. Two securities are said to rank Pari Passu when there is no difference as to dividend, voting power and other rights between them.

Participating: The right to participate further in profits after a specified dividend is paid.

Partly-paid: (Cf.: Contributory) Shares on which the full nominal value has not been called up are called "partly-paid" up.

Preference Shares: Shares on which a fixed dividend is paid prior to that on ordinary shares.

Premium: Amount above the par value of a stock.

Profit-taking: Selling to take profit.

Dividend Cover: Denotes the number of times equity earning per share covers the equity dividend per share.

Proxy: A person who acts for another in a company's general meeting. A proxy has no right to speak at a meeting.

Rally: A brisk rise following a fall.

Record Date: The date on which a member must be registered in the books of the company to be entitled to dividend or other rights.

Short Covering: Buying of stocks by a seller to complete his previous commitments.

Speculation: Employment of funds by a person to assume a relatively large risk in the hope of gain.

Split: Sub-division of a share of large denomination into shares of smaller denominations. Also means sub-division holdings.

Stop loss: An order to a broker to buy or sell a specified security when a specified price (called stop price) is reached.

Taxable: When used in connection with dividend or interest, means that the dividend or interest will be paid after deduction of tax payable by the company on its profits.

Tax-free: Means that the tax payable by the company on its profits will not be deducted from the dividend or interest.

Technical Position: Condition of market created by various internal factors, and opposed to external forces.

Yield: The dividend expressed as a percentage of current price.