

Unit 4

What is Secondary Market?

Also known as aftermarket, is the follow on of public offering in the market. It is the place where stocks, bonds, options and futures, issued previously, are bought and sold. Simply put, it is a marketplace where securities issued earlier, are sold and purchased.

Products in Secondary market:

- Equity:

Equity is the ownership in a company where all the shareholders have equal rights irrespective of the number of shares held by them. This includes:

1. Equity shares
2. Right issue or Right share
3. Bonus shares

- Preference shares:

Preferred shares also referred to as Preferred stocks. It is a form of stock which is a mix of features, not possessed by common stock properties, it is generally considered as a Hybrid Instrument.

Owners of these securities are entitled to a fixed dividend to be paid regularly before any dividend can be paid on Equity shares. The preference shares are categorized into:

1. Cumulative preference shares
2. Participating preference shares

- Government Securities(G-sec):

G-sec is a bond or debt obligation that is issued by Reserve Bank of India on behalf of Government of India, in substitute of the central government's market borrowing programme with a promise of repayment upon the security maturity date.

These are generally considered as low-risk investments because they are backed by the taxing power of a government.

These securities have fixed coupon that is paid on specific dates on half-yearly basis.

- Debentures:

Debentures are referred to as long-term securities bearing a fixed rate of interest which are issued by a company and secured against the assets. These are usually payable half yearly on specific dates with principal amount repayable on maturity date.

Debentures are divided into two categories:

1. Non-convertible debentures
2. Convertible debentures

- Bonds:

Bond is a negotiable instrument generally issued by a company, municipality or government agency which provides evidence of indebtedness. An investor in bond lends money to the issuer and the issuer in exchange promises to repay the loan on a specified maturity date. The issuer pays interest periodically over the tenure of the loan. Its tenure can be upto 30 years. There are various types of bonds:

1. Zero Coupon Bonds
2. Convertible Bonds
3. Commercial paper
4. Treasury Bills

Market Participant in Secondary Market:

- Buyers
- Sellers
- Intermediaries

Functions of Secondary Market

- A [stock exchange](#) provides a platform to investors to enter into a trading transaction of bonds, shares, debentures and such other financial instruments.
- Transactions can be entered into at any time, and the market allows for active trading so that there can be immediate purchase or selling with little variation in price among different transactions. Also, there is continuity in trading, which increases the liquidity of assets that are traded in this market.
- Investors find a proper platform, such as an organised exchange to liquidate the holdings. The securities that they hold can be sold in various stock exchanges.
- A secondary market acts as a medium of determining the pricing of assets in a transaction consistent with the demand and supply. The information about transactions price is within the public domain that enables investors to decide accordingly.

- It is indicative of a nation's economy as well, and also serves as a link between savings and investment. As in, savings are mobilised via investments by way of securities.

Types of Secondary Market

Secondary markets are primarily of two types – Stock exchanges and over-the-counter markets.

- **Stock exchange**

Stock exchanges are centralized platforms where securities trading take place, sans any contact between the buyer and the seller. [National Stock Exchange](#) (NSE) and [Bombay Stock Exchange](#) (BSE) are examples of such platforms.

1. Transactions in stock exchanges are subjected to stringent regulations in securities trading.
2. A stock exchange itself acts as a guarantor, and the counterparty risk is almost non-existent.
3. A safety net is obtained via a higher transaction cost being levied on investments in the form of commission and exchange fees.

- **Over-the-counter (OTC) market**

Over-the-counter markets are decentralized, comprising participants engaging in trading among themselves. OTC markets retain higher counterparty risks in the absence of regulatory oversight, with the parties directly dealing with each other. Foreign exchange market (FOREX) is an example of an over-the-counter market.

In an OTC market, there exists tremendous competition in acquiring higher volume. Due to this factor, the securities' price differs from one seller to another.

Apart from the stock exchange and OTC market, other **types of secondary market** include auction market and dealer market.

The former is essentially a platform for buyers and sellers to arrive at an understanding of the rate at which the securities are to be traded. The information related to pricing is put out in the public domain, including the bidding price of the offer.

Dealer market is another type of secondary market in which various dealers indicate prices of specific securities for a transaction. Foreign exchange trade and bonds are traded primarily in a dealer market.

Difference between Primary and Secondary Market

Primary Market	Secondary Market
Securities are initially issued in a primary market. After issuance, such securities are listed in stock exchanges for subsequent trading.	Trading of already issued securities takes place in a secondary market.
Investors purchase shares directly from the issuer in the primary market.	Investors enter into transactions among themselves to purchase or sell securities. Issuers are thus not involved in such trading.
The stock issue price in a primary market remains fixed.	Prices of the traded securities in a secondary market vary according to the demand and supply of the same.
Sale of securities in a primary market generates fund for the issuer.	Transactions made in this market generate income for the investors.
Issue of security occurs only once and for the first time only.	Here, securities are traded multiple times.
Primary markets lack geographical presence; it cannot be attributed to any organisational set-up as such.	A secondary market, on the contrary, has an organizational presence in the form of stock exchanges.

Functions of Stock Exchange

Some of the significant objectives or functions of the Stock Exchange are listed below:

1. **Economic Barometer:** A stock exchange is also known as a pulse of the economy or economic mirror which reflects the economic conditions of a country.
2. **Pricing of Securities:** The stock market helps to assess the securities on the basis of demand and supply factors. The securities of effective and growth-oriented organisations are estimated higher as there is more demand for such securities.
3. **Safety of Transactions:** In the stock market only the indexed securities are traded. The stock exchange authorities include the corporations named in the trade list only after verifying the soundness of the organisation. The organisations which are listed also have to function within the stringent rules and regulations.
4. **Contributes to Economic Growth:** In stock exchange securities of various organisations are traded. This method of disinvestment and reinvestment helps to invest in the most productive investment proposal and this leads to capital structure and economic growth.
5. **Spreading of Equity Cult:** Stock exchange urges people to invest in ownership securities by managing new issues, better trading practices and by educating the people about investment.

6. **Providing Scope for Speculation:** To assure liquidity and demand of supply of securities the stock exchange allows healthy consideration of securities.
7. **Liquidity:** The principal purpose of the stock market is to present a ready market for sale and purchase of securities. The presence of the stock exchange market gives certainty to investors that their investment can be transformed into cash whenever they want.
8. **Better Allocation of Capital:** The shares of profit-making organisations are valued at higher prices and are actively traded so such organisations can efficiently raise capital from the stock market.
9. **Promotes the Habits of Savings and Investment:** The stock market gives attractive chances for investment in different securities. These attractive opportunities inspire people to save more and invest in securities of the corporate sector rather than investing in unfruitful assets such as gold, silver, etc.,

Functional Specializations of Members at the Stock Exchange of India

1. Commission broker:

Almost all members act as commission brokers-The commission broker executes buying and selling orders on the floor of the exchange. For that, he charges a commission not exceeding the official scale of brokerage.

2. Floor broker:

The floor brokers are not officially attached to other members. The floor broker executes orders for any members and receives as his compensation a share of the brokerage charged by the commission broker to his constituent. Such brokers are not found on Indian stock exchanges.

3. Taravnmalla or jobber:

The taravniwalla may be a jobber or specialist who specialises in stocks located at the same trading post. He trades in and out of the market for a small difference in price and as such is an important factor in “making a market”, i.e. maintaining a continuous and liquid market in stock in which he specialises.

4. Dealers in non-cleared securities:

The dealer in non-cleared securities specialises in buying and selling on his own account shares which are not in the active list. He is generally prepared to buy what is on offer and sell what is required but the price at which he deals varies with the activity of the particular stock.

5. Odd-lot dealer:

The odd-lot dealer specialises in buying and selling in amount less than the prescribed trading units or lots. He buys odd lots and makes them up into marketable trading units. He likewise sells odd-lots obtained by buying or by splitting up round lots. The odd-lot dealer does not rely on commission but earns his profit on the difference between the prices at which he buys and sells.

6. Budliwalla:

The budliwalla or financier lends money to the market by taking up delivery on the due date at the end of the clearing for those who wish to carry over their purchases; or loans securities to the market when it is short by giving delivery on the due date at the end of the clearing for those who wish to carry over their sales.

7. Arbitrageur:

The arbitrageur specialises in making purchases and sales in different markets at the same time and profits by the differences in prices between the two centres. Arbitrage depends on the number of securities dealt in the common on more than one stock exchange and the existence of ready means of communication.

8. Security dealer:

The security dealer specialises in buying and selling gilt- edged securities, that is, securities issued by the Central and State Governments and by statutory public bodies such as Municipal Corporation, Improvement Trusts and Electricity Boards. He acts mainly as jobber and is prepared to take risks inherent in the ready purchase and sale of securities to meet current requirements.

UNIT-5

What do you mean by financial service?

Financial Services is a term used to refer to the services provided by the finance market. Financial Services is also the term used to describe organizations that deal with the management of money. Examples are the Banks, investment banks, insurance companies, credit card companies and stock brokerages.

The main types of financial services for you to consider:

- Banking: Banking includes handing deposits into checking and savings accounts, as well as lending money to customers.
- Advisory: Expert advisory services help both people and organizations with a variety of tasks.
- Wealth Management.
- Mutual Funds.
- Insurance.

Financial services

It may be include two types

1. Fund or amount based financial services
2. Fee based advisory services

1) Fund or amount based financial services

- a) Lease finance
- b) Higher purchase finance and consumer credit
- c) Factoring and forfeiting
- d) Bill discounting insurance services
- e) Venture capital finance

2) Fee based advisory services

- a) Consultancy
- b) Advisory services
- c) Issue management etc

Mutual Funds

Mutual funds is pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market investments etc.

Meaning of Merchant Bank

A merchant bank is a financial institution providing capital to companies in the form of share ownership instead of loans. Merchant bank also provides advisory on corporate matter to the firm which they invest. The historical term “Merchant Bank” refers to an investment bank.

Role of merchant banker in the capital market

1. Issue management

Issue management means managing of the capital through issue of different financial instruments. These kind of professional services are rendered by merchant bankers.

2. Underwriting

A company issuing shares & debentures are exposed to the risk of issue not being fully subscribed. Here, the underwriter promises to purchase the shares if in case some shares are left unsubscribed. Generally merchant bankers act as underwriter for new issues of companies.

3. Corporate counselling

Merchant bankers also provide services of corporate financial management like

- i. Economic analysis of product range
- ii. Cost analysis, pricing strategies etc, financial management, long term finance etc
- iii. Legal counselling

4. Government consent

Obtaining necessary approvals licenses and permission from the Govt. for Industrial projects.

5. Credit syndication

It involves raising of finance with the help of consent of bank and financial institution.

6. Portfolio management

The merchant banker takes up the responsibility of portfolio management of their client to optimize the return on investment.

- i. Advise on investment in government securities
- ii. Undertaking purchase or sales of securities
- iii. Management of individuals investment portfolio of investors.

7. Arranging of shares finance

Merchant bank helps their client in foreign currency financing . it includes financing of imports and exports, long term foreign currency loan etc.

Types of mutual funds

a) Money market mutual fund

These funds are invested in short term fixed income securities such as Government-bonds ,treasury bills, bankers acceptance, commercial paper & certificate of deposit.

b) Fixed income fund

The fund gives a fixed rate of return. Example –Government Bank, Corporate bonds etc.

c) Equity fund

In this fund the money is invested in stock. These funds aim to grow faster than money market or fixed income funds.

d) Balanced fund

This fund invested in a mixture of equities and fixed income securities. They try to balance the aim of achieving higher return against the risk of losing money among the different types of investments.

e) Index fund

These fund aim to track the performance of a specific index. The value of the mutual fund will go up or down as index goes up or down.

f) Specialty fund

This type of mutual fund focuses on investing in specific industry or sector of the economy.

Example – Textile Industry, Petroleum Industry etc.

Credit rating

Credit rating means evaluating the creditor risk of a prospective debtor. It is the assessment of the creditworthiness of a borrower. It is based on the history of borrowing and payment as well. It also includes the availability of assets.

Rating is done to know the ability of the borrower to meet the obligation in timely manner.

Objectives of credit rating

- i. Provide superior information to the investor.
- ii. Low cost information relating to risk return and trade-off is provided to the investor.
- iii. Improves a healthy discipline among the borrowers.
- iv. Facilitates formulation of public guardianship on institutional investment.
- v. Helps merchant bankers, regulatory authorities in discharging their functions related to data issues.

Benefits of credit rating to investors

1. Helps in Investment Decision: Credit rating gives an idea to the investors about the credibility of the issuer company, and the risk factor attached to a particular instrument. So the investors can decide whether to invest in such companies or not. Higher the rating, the more will be the willingness to invest in these instruments and vice-versa.
2. Benefits of Rating Reviews: The rating agency regularly reviews the rating given to a particular instrument. So, the present investors can decide whether to keep the instrument or to sell it. For e.g. if the instrument is downgraded, then the investor may decide to sell it and if the rating is maintained or upgraded, he may decide to keep the instrument until the next rating or maturity.
3. Assurance of Safety: High credit rating gives assurance to the investors about the safety of the instrument and minimum risk of bankruptcy. The companies which get a high rating for

their instruments will try to maintain healthy financial discipline. This will protect them from bankruptcy. So the investors will be safe.

4. **Easy Understandability of Investment Proposal:** The rating agencies give rating symbols to the instrument, which can be easily understood by investors. This helps them to understand the investment proposal of an issuer company. For e.g. AAA (Triple A), given by CRISIL for debentures ensures highest safety, whereas debentures rated D are in default or expect to default on maturity.
5. **Choice of Instruments:** Credit rating enables an investor to select a particular instrument from many alternatives available. This choice depends upon the safety or risk of the instrument.
6. **Saves Investor's time and effort:** Credit ratings enable an investor to his save time and effort in analyzing the financial strength of an issuer company. This is because the investor can depend on the rating done by professional rating agency, in order to take an investment decision.

Benefits of rating to borrower company

- i. Low cost of borrowing.
 - ii. Wider audience for borrowing.
 - iii. Rating becomes a marketing tool.
 - iv. Companies become self discipline.
 - v. Motivation for growth.
 - vi. Merchant bankers job is made easy.
 - vii. Foreign collaboration are made easy.
1. **Improves Corporate Image:** Credit rating helps to improve the corporate image of a company. High credit rating creates confidence and trust in the minds of the investors about the company. Therefore, the company enjoys a good corporate image in the market.
 2. **Lowers Cost of Borrowing :** Companies that have high credit rating for their debt instruments will get funds at lower costs from the market. High rating will enable the company to offer low interest rates on fixed deposits, debentures and other debt securities. The investors will accept low interest rates because they prefer low risk instruments. A company with high rating for its instruments can reduce the cost of public issue to raise funds, because it need not spend heavily on advertising for attracting investors.
 3. **Wider Audience for Borrowing :** A company with high rating for its instruments can get a wider audience for borrowing. It can approach financial institutions, banks, investing

companies. This is because the credit ratings are easily understood not only by the financial institutions and banks, but also by the general public.

4. **Good for Non-Popular Companies:** Credit rating is beneficial to the non-popular companies, such as closely-held companies. If the credit rating is good, the public will invest in these companies, even if they do not know these companies.
5. **Act as a Marketing Tool:** Credit rating not only helps to develop a good image of the company among the investors, but also among the customers, dealers, suppliers, etc. High credit rating can act as a marketing tool to develop confidence in the minds of customers, dealer, suppliers, etc.
6. **Helps in Growth and Expansion:** Credit rating enables a company to grow and expand. This is because better credit rating will enable a company to get finance easily for growth and expansion.

List of credit rating agencies.

CRISIL- Credit Rating Information Services Of India Limited

ICRA- Investment Information & Credit Rating Agency Of India.

CARL- Credit Analysis & Research Limited

BWR- Brick Work Ratings

SMERA- Small & Medium Enterprises Rating Agency Of India