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Investment in India: A Study About Indian Stock Market

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Abstract

Investments are important because in today's world, just earning money is not enough. You work hard for the money you earn. But that may not be adequate for you to lead a comfortable lifestyle or fulfill your dreams and goals. To do that, you need to make your money work hard for you as well. This is why you invest. Money lying idle in your bank account is an opportunity lost. You should invest that money smartly to get good returns out of it. Stock markets form the largest avenues for investments. There are primarily two stock exchanges in India, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Companies list their shares for the first time in the primary market and in the secondary markets investors can buy and sell their shares during an Initial Public Offering. The two stock exchanges in India have on some occasions witnessed stocks worth INR 6,00,000 crores being traded. The uninitiated in India often consider investing in stocks markets gambling, but a basic understanding of the share market can change that perception. A stock market is a platform where investors come to trade in financial instruments like shares, bonds, and derivatives. The stock exchange works as a facilitator of this transaction and enables the buying and selling of shares. The regulation and supervision of the stocks markets in India rest with the Securities and Exchange Board of India. SEBI was formed as an independent identity under the SEBI Act of 1992 and has the power to conduct inspections of the stock exchanges. The inspections review the operations of the market and the organizational structure along with aspects of administrative control.

Keywords: *Share Market, Investment, NationalStock Exchange, Bombay Stock Exchange*

Introduction

A share market is where shares are either issued or traded in. A stock market is similar to a share market. The key difference is that a stock market helps you trade financial instruments like bonds, mutual funds, derivatives as well as shares of companies. A share market only allows trading of shares.

The key factor is the stock exchange - the basic platform that provides the facilities used to trade company stocks and other securities. A stock may be bought or sold only if it is listed on an exchange. Thus, it is the meeting place of the stock buyers and sellers. India's premier stock exchanges are the Bombay Stock Exchange and the National Stock Exchange.

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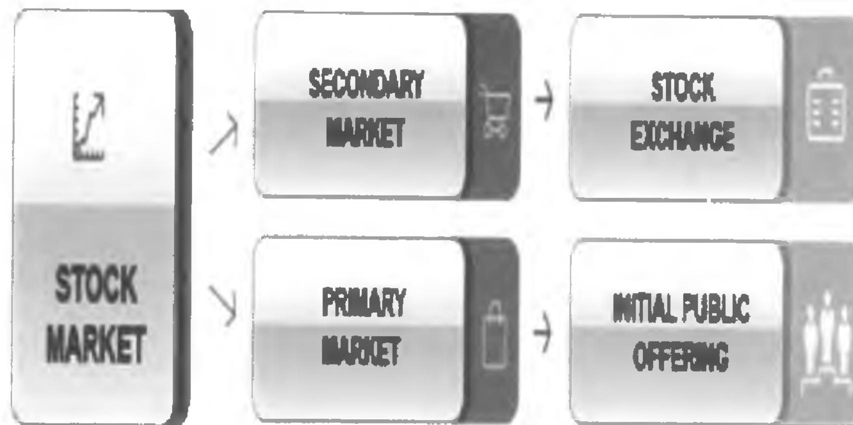
Figure.1: Stock Market



Types of Investments in India

The Indian investor has a number of investment options to choose from. Some are traditional investments that have been used across generations, while some are relatively newer options that have become popular in recent years. Here are some popular investment options available in India.

- **Stocks**

  Stocks, also known as company shares, are probably the most famous investment vehicle in India. When you buy a company's stock, you buy ownership in that company that allows you to participate in the company's growth. Stocks are offered by companies that are publicly listed on stock exchanges and can be bought by any investor. Stocks are ideal long-term investments. But investing in stocks should not be equated to trading in the stock market, which is a speculative activity.

- **Mutual Funds**

  Mutual funds have been around for the past few decades but they have gained popularity only in the last few years. These are investment vehicles that pool the money of many investors and invest it in a way to earn optimum returns. Different types of mutual funds invest in different securities. Equity mutual funds invest primarily in stocks and equity-related instruments, while debt mutual funds invest in bonds and papers. There are also hybrid mutual funds that invest in equity as well as debt. Mutual funds are flexible investment vehicles, in which you can begin and stop investing as per your convenience. Apart from tax-saving mutual funds, you can redeem investments from mutual funds any time as well.

- **Fixed Deposits**

  Fixed deposits are investment vehicles that are for a specific, pre-defined time period. They offer complete capital protection as well as guaranteed returns. They are ideal for conservative investors who stay away from risks. Fixed deposits are offered by banks and

for different time periods. Fixed deposit interest rates change as per economic conditions and are decided by the banks themselves. Fixed deposits are typically locked-in investments, but investors are often allowed to avail loans or overdraft facilities against them. There is also a tax-saving variant of fixed deposit, which comes with a lock-in of 5 years.

- **Recurring Deposits**

  A recurring deposit (RD) is another fixed tenure investment that allows investors to put in a specific amount every month for a pre-defined period of time. RDs are offered by banks and post offices. The interest rates are defined by the institution offering it. An RD allows the investor to invest a small amount every month to build a corpus over a defined time period. RDs offer capital protection as well as guaranteed returns.

- **Public Provident Fund**

  The Public Provident Fund (PPF) is a long-term tax-saving investment vehicle that comes with a lock-in period of 15 years. Investments made in PPF can be used to earn a tax break. The PPF rate is decided by the Government of India every quarter. The corpus withdrawn at the end of the 15-year period is completely tax-free in the hands of the investor. PPF also allows loans and partial withdrawals after certain conditions have been met.

- **Employee Provident Fund**

  The Employee Provident Fund (EPF) is another retirement-oriented investment vehicle that earns a tax break under Section 80C. EPF deductions are typically a part of an earner's monthly salary and the same amount is matched by the employer as well. Upon maturity, the withdrawn corpus from EPF is also entirely tax-free. EPF rates are also decided by the Government of India every quarter.

- **National Pension System**

  The National Pension System (NPS) is a relatively new tax-saving investment option. Investors in the NPS stay locked-in till retirement and can earn higher returns than PPF or EPF since the NPS offers plan options that invest in equities as well. The maturity corpus from the NPS is not entirely tax-free and a part of it has to be used to purchase an annuity that will give the investor a regular pension.

  Since there are so many types of investment vehicles, it is normal for an investor to get overwhelmed. Someone new to investing would not where to invest their money. Making the wrong investment choice can lead to financial losses, which is something that no one wants. This is why one should use the following factors to decide where to invest the money.

- **Age**

  Typically, younger investors have fewer responsibilities and a longer time horizon. When you have a long working life in front of you, you can invest in vehicles with a long-term view and also keep increasing your investment amount with an increase in your income. This is why equity-oriented investments like equity mutual funds would be a better option for young investors, as compared to something like fixed deposits. But on the other hand, older investors can opt for safer avenues like FDs.

- **Goal**

  Investment goals can be either short-term or long-term. For a short-term goal, you should opt for a safer investment and use the return-generating potential of equities for long-term goals. Goals can also be negotiable and non-negotiable. For non-negotiable goals like children's education or down payment for a house, guaranteed-return investments would be a good choice. But if the goal is negotiable, which means that it can be pushed back by a few months, then investing in equity mutual funds or stocks can be beneficial. Plus, if these investments do really well, then you can even meet the goal before time.

- **Profile**

  Another thing to think about when choosing an investment option is your own profile. Factors like how much you are earning and how many financial dependants you have are also critical. A young investor with a lot of time on hand may not be able to take equity-related risks if he also has the responsibility to take care of his family. Similarly, someone older with no dependents and a steady source of income can choose to invest in equities to earn higher returns.

This is why it is said that when it comes to investments, one size doesn't fit all. Investments not only have to be chosen carefully but also planned properly to get the most out of them.

Planning of the Investments

The first step in planning investments is to figure out the right investment that fits the profile and needs. Here are a few things to keep in mind when planning the investments:

- Choose investments carefully after doing adequate research
- Don't fall for quick-buck schemes that promise high returns in a short time
- Review your stock and mutual fund investments periodically
- Consider the tax implications on returns you earn from your investments
- Keep things simple and avoid complicated investments that you don't understand

Figure.2: Stock Market Participants

Investing in the share market is risky. Hence, they need to be regulated to protect investors. The Security and Exchange Board of India (SEBI) is mandated to oversee the secondary and primary markets in India since 1988 when the Government of India established it as the regulatory body of stock markets. Within a short period of time, SEBI became an autonomous body through the SEBI Act of 1992. SEBI has the responsibility of both development and regulation of the market. It regularly comes out with comprehensive regulatory measures aimed at ensuring that end investors benefit from safe and transparent dealings in securities.

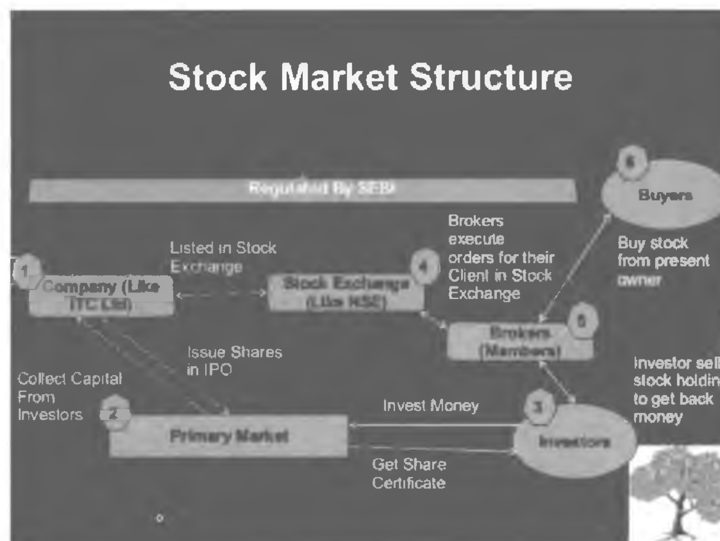
Basic Objectives of SEBI:

- Protecting the interests of investors in stocks
- Promoting the development of the stock market
- Regulating the stock market

Role of SEBI:

- Ensuring a fair and equitable market for investors to grow in.
- Compliance of the exchange organization, the system its practices in accordance with the rules framed under the Securities Contracts (Regulation) Act (SC(R) Act), 1956
- Ensure implementation of the guidelines and directions issued by the SEBI
- Check if the exchange has complied with all the conditions and has renewed the grants, if needed, under Section 4 of the SC(R) Act of 1956.

Figure.3: Stock Market Structure



Types of Share Markets

There are two kinds of share markets namely the Primary and the Secondary Markets.

a. **Primary Share Market**

It is in the primary market that companies register themselves to issue their shares and raise money. This process is also known as listing on the stock exchange. The purpose of entering into the primary market is to raise money and if the company is selling their shares for the very first time it is referred to as the Initial Public Offering (IPO). Through this process, the company becomes a public entity.

b. **Secondary Market**

The shares of a company are traded in the secondary market once the new securities are sold in the primary market. This way investors can exit by selling their shares. These transactions that take place in the secondary market are called trades. It involves the activity of investors buying from each other and selling amongst themselves at an agreed upon price. A broker is the intermediary that facilitates these transactions.

The Indian stock market is represented by 2 stock exchanges, that facilitate the buying and selling of a company's stock via your stockbroker. These are:

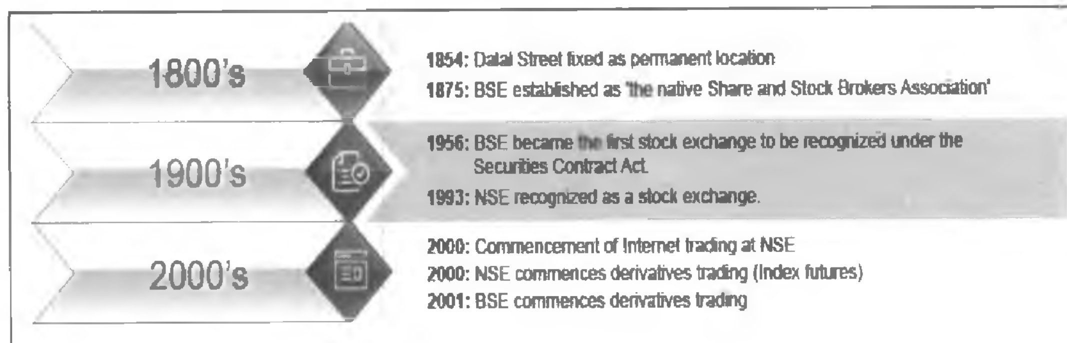
- National Stock Exchange (NSE), which has around 2000 companies listed on it. The index used here is Nifty.
- Bombay Stock Exchange (BSE), which has approximately 5000 companies listed on it. The index used here is Sensex.

The company stocks that are traded on these exchanges range from as low as ?0.5 to as high as ?70,000.

The BSE and NSE

Most of the trading in the Indian stock market takes place on its two stock exchanges: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE has been in existence since 1875. The NSE, on the other hand, was founded in 1992 and started trading in 1994. However, both exchanges follow the same trading mechanism, trading hours, and settlement process. As of February 2020, the BSE had 5,518 listed firms, whereas the rival NSE had about 1,799 as of Dec. 31, 2019. Out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization; the rest of the crowd consists of highly illiquid shares. Almost all the significant firms of India are listed on both the exchanges. The BSE is the older stock market but the NSE is the largest stock market, in terms of volume. As such, the NSE is a more liquid market. In terms of market cap, they're both comparable at about $2.3 trillion. Both exchanges compete for the order flow that leads to reduced costs, market efficiency, and innovation. The presence of arbitrageurs keeps the prices on the two stock exchanges within a very tight range.

Figure.4: BSE and NSE



Investing in Share Market

We invest in shares to build our wealth in the long run. While some people view shares to be a risky investment, many studies have proved that putting your money in the right shares for a long period of time (five to 10 years) can provide inflation-beating returns - and be a better investment option than real estate and gold. People also have short-term strategies while investing in share markets. While shares can be volatile over a short period of time, investing in the right shares can help traders make quick profits. Earlier, stockbrokers would converge around Banyan trees to conduct trades of stocks. As the number of brokers increased and the streets overflowed, they simply had no choice but to relocate from one place to another. Finally in 1854, they relocated to Dalal Street, the place where the oldest stock exchange in Asia - the Bombay Stock Exchange (BSE) - is now located. It is also India's first stock exchange and has since then played an important role in the Indian stock markets. Even today, the BSE Sensex remains one of the parameters against which the robustness of the Indian economy and finance is measured.

In 1993, the National Stock Exchange or NSE was formed. Within a few years, trading on both the exchanges shifted from an open outcry system to an automated trading environment. This shows that Indian stock markets have a strong history. Yet, at the face of it, especially when you consider to invest in share market, it often seems like a maze. But once you start, you will realize that the investment fundamentals are not too complicated. One of the basics of investment fundamentals is financial planning. Read more about the importance of financial planning.

Trading Mechanism

Trading at both the exchanges takes place through an open electronic limit order book in which order matching is done by the trading computer. There are no market makers and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous. The advantage of an order-driven market is that it brings more transparency by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed. All orders in the trading system need to be placed through brokers, many of which provide an online trading facility to retail

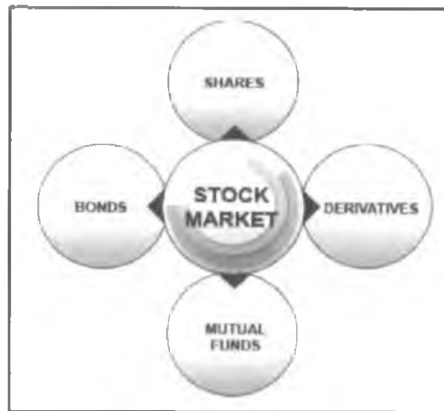
customers. Institutional investors can also take advantage of the direct market access (DMA) option in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system.

Financial Instruments Traded in a Stock Market:

The main four key financial instruments that are traded in Stock market:

- Bonds
- Shares
- Derivatives
- Mutual Fund

Figure.5: Financial Instruments Traded in a Stock Market



- **Bonds:**

  Companies need money to undertake projects. They then pay back using the money earned through the project. One way of raising funds is through bonds. When a company borrows from the bank in exchange for regular interest payments, it is called a loan. Similarly, when a company borrows from multiple investors in exchange for timely payments of interest, it is called a bond. Click here to read about the importance of tracking bond yield movements.

  For example, imagine you want to start a project that will start earning money in two years. To undertake the project, you will need an initial amount to get started. So, you acquire the requisite funds from a friend and write down a receipt of this loan saying 'I owe you Rs 1 lakh and will repay you the principal loan amount by five years, and will pay a 5% interest every year until then'. When your friend holds this receipt, it means he has just bought a bond by lending money to your company. You promise to make the 5% interest payment at the end of every year, and pay the principal amount of Rs 1 lakh at the end of the fifth year.Thus, a bond is a means of investing money by lending to others. This is why it is called a debt instrument. When you invest in bonds, it will show the face value - the amount of money being borrowed, the coupon rate or yield - the interest rate that the borrower has to pay, the coupon or interest payments, and the deadline for paying the money back called as the maturity date. If you're looking for a bond option that helps you save tax, you can read about tax free bonds.

- **Shares**

  Shares are thus, a certificate of ownership of a corporation. Thus, as a stockholder, you share a portion of the profit the company may make as well as a portion of the loss a company may take. As the company keeps doing better, your stocks will increase in value. Read more about different types of stocks.

- **Mutual Funds:**

  These are investment vehicles that allow you to indirectly investing in share market market or bonds. It pools money from a collection of investors, and then invests that sum in financial instruments. This is handled by a professional fund manager. Every mutual fund scheme issues units, which have a certain value just like a share. When you invest, you thus become a unit-holder. When the instruments that the MF scheme invests in make money, as a unit-holder, you get money. This is either through a rise in the value of the units or through the distribution of dividends - money to all unit-holders. Click here to start your journey into mutual funds

- **Derivatives:**

  The value of financial instruments like shares keeps fluctuating. So, it is difficult to fix a particular price. Derivatives instruments come handy here. These are instruments that help you trade in the future at a price that you fix today. Simply put, you enter into an agreement to either buy or sell a share or other instrument at a certain fixed price. Read more to understand how to buy or sell a futures contract.

Types of Stocks

Stocks can be classified into multiple categories on various parameters - size of the company, dividend payment, industry, risk, volatility, as well as fundamentals.

- **Stocks on the Basis of Ownership Rules:**

  This is the most basic parameter for classifying stocks. In this case, the issuing company decides whether it will issue common, preferred or hybrid stocks.

- **Preferred & Common Stocks:**

  The key difference between common and preferred stocks is in the promised dividend payments. Preferred stocks promise investors that a fixed amount will be paid as dividends every year. A common stock does not come with this promise. For this reason, the price of a preferred stock is not as volatile as that of a common stock. Another key difference between a common stock and a preferred stock is that the latter enjoy greater priority when the company is distributing surplus money. However, if the company is getting liquidated - its assets are being sold off to pay off investors, then the claims of preferred shareholders rank below that of the company's creditors, and bond- or debenture-holders. Another distinction is that preferred shareholders may not have voting rights unlike holders of common stocks.

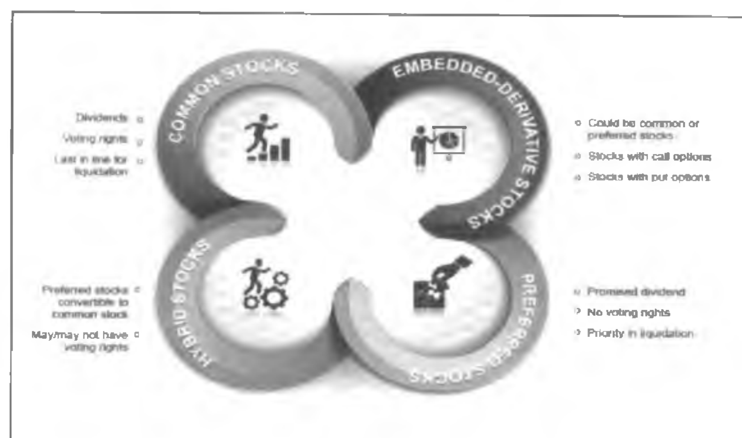
- **Hybrid Stocks:**

  Some companies also issue hybrid stocks. These are often preferred shares that come with

an option to be converted into a fixed number of common stocks at a specified time. These kinds of stocks are called 'convertible preferred shares'. Since these are hybrid stocks, they may or may not have voting rights like common stocks.

- **Stocks with Embedded-derivative Options:**

  Some stocks come with an embedded derivative option. This means it could be 'callable' or 'putable'. A 'callable' stock is one which has the option to be bought back by the company at a certain price or time. A 'putable' share gives the stockholder the option to sell it to the company at a prescribed time or price. These kinds of stocks are not commonly available.



- **Stocks on the Basis of Market Capitalization:**

  Stocks are also classified on the basis of the market value of the total shareholding of a company. This is calculated using market capitalization, where you multiply the share price by the total number of issued shares. There are three kinds of stocks on the basis of market capitalization.

- **Small-Cap Stocks:**

  — 'Cap' is the short form of 'Capitalization'. As the name suggests, these are stocks with the smallest values in the market. They often represent small-size companies. Generally companies that have a market capitalization in the range of up to Rs. 250 crore are small cap stocks.

  — These stocks are the best option for an investor who wishes to generate significant gains in the long run; as long he does not require current dividends and can withstand price volatility. This is because small companies have the potential to grow rapidly in the future. So, an investor may profit by buying the stock when it is cheaply available in the company's initial stage. However, many of these companies are relatively new. So, it is difficult to predict how they will perform in the market.

  — Being small enterprises, growth spurts dramatically affect their values and revenues, sending prices soaring. On the other hand, the stocks of these companies tend to be volatile and may decline dramatically.

- **Mid-Cap Stocks:**
  - Mid-cap stocks are typically stocks of medium-sized companies. Generally, companies that have a market capitalization in the range of Rs. 250 crore and Rs. 4,000 crore are mid-cap stocks.
  - These are stocks of well-known companies, recognized as seasoned players in the market. They offer you the twin advantages of acquiring stocks with good growth potential as well as the stability of a larger company.
  - Mid-cap stocks also include baby blue chips - companies that show steady growth backed by a good track record. They are like blue-chip stocks (which are large-cap stocks), but lack their size. These stocks tend to grow well over the long term.
- **Large-Cap Stocks:**
  - Stocks of the largest companies in the market such as Tata, Reliance, ICICI are classified as large-cap stocks. They are often blue-chip firms.
  - Being established enterprises, they have at their disposal large reserves of cash to exploit new business opportunities. However, the sheer size of large-cap stocks does not let them grow as rapidly as smaller capitalized companies and the smaller stocks tend to outperform them over time.
  - Investors, however, gain the advantages of reaping relatively higher dividends compared to small- and mid-cap stocks, while also ensuring the long-term preservation of their capital.

Some stocks are riskier than others. This is because their share prices fluctuate more. However, just because a stock is risky does not mean investors should avoid it. Risky stocks have the potential to make you greater profits. Low-risk stocks, in contrast, give you lower returns.

- **Blue-Chip Stocks:**

  These are stocks of well-established companies with stable earnings. These companies have lower liabilities like debt. This helps the companies pay regular dividends. Blue-chip stocks are thus considered safe and stabile. They are named after blue-colored chips in the game of poker, as the chips are considered the most valuable.

- **Beta Stocks:**

  Analysts measure risk - called beta - by calculating the volatility in its price. Beta values can have positive or negative values. The sign merely denotes if the stock is likely to move in sync with the market or against the market. What really matters is the absolute value of beta. Higher the beta, greater the volatility and thus more the risk. A beta value over 1 means the stock is more volatile than the market. Thus, high beta stocks are riskier. However, a smart investor can use this to make greater profits.

Prices of Stocks Often Move in Tandem with Company Earnings. Stocks are Thus Classified into Two Groups:

- **Cyclical Stocks:**

  Some companies are more affected by economic trends. Their growth moderates in a slow economy, or fastens in a booming economy. As a result, prices of such stocks tend to fluctuate more as economic conditions change. They rise during economic booms, and fall as the economy slows down. Stocks of automobile companies are the best example of cyclical stocks.

- **Defensive Stocks:**

  Unlike cyclical stocks, defensive stocks are issued by companies relatively unmoved by economic conditions. Best examples are stocks of companies in the food, beverages, drugs and insurance sectors. Such stocks are typically preferred when economic conditions are poor, while cyclical stocks are preferred when the economy is booming.

Settlement and Trading Hours

Equity spot markets follow a T+2 rolling settlement. This means that any trade taking place on Monday gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 a.m. and 3:30 p.m., Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk by serving as a central counterparty.

Market Indexes

The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 47% of the index's free-float market capitalization. It was created in 1986 and provides time series data from April 1979, onward. Another index is the Standard and Poor's CNX Nifty; it includes 50 shares listed on the NSE, which represent about 46.9% of its free-float market capitalization. It was created in 1996 and provides time series data from July 1990, onward.

Market Regulation

The overall responsibility of development, regulation, and supervision of the stock market rests with the Securities and Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach. India started permitting outside investments only in the 1990s. Foreign investments are classified into two categories: foreign direct investment (FDI) and foreign portfolio investment (FPI). All investments in which an investor takes part in the day-to-day management and operations of the company are treated as FDI, whereas investments in shares without any control over management and operations are treated as FPI. For making portfolio investments in India, one should be registered either as a foreign institutional investor (FII) or as one of the sub-accounts of one of the registered FIIs. Both registrations are granted by the market regulator, SEBI. Foreign institutional investors mainly consist of mutual funds, pension funds, endowments, sovereign wealth funds, insurance

companies, banks, and asset management companies. At present, India does not allow foreign individuals to invest directly in its stock market. However, high-net-worth individuals (those with a net worth of at least $50 million) can be registered as sub-accounts of an FII. Foreign institutional investors and their sub-accounts can invest directly into any of the stocks listed on any of the stock exchanges. Most portfolio investments consist of investment in securities in the primary and secondary markets, including shares, debentures, and warrants of companies listed or to be listed on a recognized stock exchange in India. FIIs can also invest in unlisted securities outside stock exchanges, subject to the approval of the price by the Reserve Bank of India. Finally, they can invest in units of mutual funds and derivatives traded on any stock exchange. An FII registered as a debt-only FII can invest 100% of its investment into debt instruments. Other FIIs must invest a minimum of 70% of their investments in equity. The balance of 30% can be invested in debt. FIIs must use special non-resident rupee bank accounts in order to move money in and out of India. The balances held in such an account can be fully repatriated.

Restrictions and Investment Ceilings

The government of India prescribes the FDI limit, and different ceilings have been prescribed for different sectors. Over a period of time, the government has been progressively increasing the ceilings. FDI ceilings mostly fall in the range of 26% to 100%. By default, the maximum limit for portfolio investment in a particular listed firm is decided by the FDI limit prescribed for the sector to which the firm belongs. However, there are two additional restrictions on portfolio investment. First, the aggregate limit of investment by all FIIs, inclusive of their sub-accounts in any particular firm, has been fixed at 24% of the paid-up capital. However, the same can be raised up to the sector cap, with the approval of the company's boards and shareholders. Secondly, investment by any single FII in any particular firm should not exceed 10% of the paid-up capital of the company. Regulations permit a separate 10% ceiling on investment for each of the sub-accounts of an FII, in any particular firm. However, in the case of foreign corporations or individuals investing as a sub-account, the same ceiling is only 5%. Regulations also impose limits for investment in equity-based derivatives trading on stock exchanges.

Investments for Foreign Entities

Foreign entities and individuals can gain exposure to Indian stocks through institutional investors. Many India-focused mutual funds are becoming popular among retail investors. Investments could also be made through some of the offshore instruments, like participatory notes (PNs), depositary receipts, such as American depositary receipts (ADRs) and global depositary receipts (GDRs), exchange-traded funds (ETFs), and exchange-traded notes (ETNs).

As per Indian regulations, participatory notes representing underlying Indian stocks can be issued offshore by FIIs, only to regulated entities. However, even small investors can invest in American depositary receipts representing the underlying stocks of some of the well-known Indian firms, listed on the New York Stock Exchange and Nasdaq. ADRs are denominated in dollars and subject to the regulations of the U.S. Securities and Exchange Commission (SEC). Likewise, global depositary receipts are listed on European stock exchanges. However, many promising Indian firms are not yet using ADRs or GDRs to access offshore investors. Retail

investors also have the option of investing in ETFs and ETNs, based on Indian stocks. India focused ETFs mostly make investments in indexes made up of Indian stocks. Most of the stocks included in the index are the ones already listed on the NYSE and Nasdaq. As of 2020, two of the most prominent ETFs based on Indian stocks are iShares MSCI India ETF (INDA) and the Wisdom-Tree India Earnings Fund (EPI). The most prominent ETN is the iPath MSCI India Index Exchange Traded Note (INPTF). Both ETFs and ETNs provide a good investment opportunity for outside investors. Foreigners Invest in the Indian Stock Markets

Indian stock markets are specifically for Indian citizens to trade. But there are ways for foreigners to invest as well. Portfolio Investment Scheme (PIS), developed by RBI, allows eligible entities, such as foreign institutional investors (FIIs), non-resident Indians (NRIs), persons of Indian origin (PIOs) and qualified foreign investors (QFIs) to invest in stocks and convertible debentures of Indian companies.

NRIs and PIOs Can Invest in the Indian Stock Markets

NRIs and PIOs are eligible to trade stocks and convertible debentures of Indian firms through a registered broker.

Figure.6: NRIs and PIOs as per the Finance Bill, 2020

NRI	Anyone who has been in India for more than 182 days during a financial year and more than 365 days during the preceding four financial years qualifies as an NRI. According to the Finance Bill, 2020, this period is reduced to 120 days if the total annual Indian income of such an individual is more than Rs.15 lakh. NRIs can continue to enjoy non-resident status if their presence in the country is 60 days or more but less than 182 days in any financial year, even if their stay in India during the past four financial years is more than 365 days. Anyone, who has been deputed overseas for more than 6 months, also qualifies for non-resident status in India.
PIO	A foreign citizen of Indian origin residing outside India and has held an Indian passport at any time or who himself or his father or grandfather was a citizen of India.

Qualified Foreign Investors (QFIs)

At the beginning of the year 2012, the government of India gave a new year gift to the stock markets. It allowed Qualified Foreign Investors (QFIs), including overseas individuals, to invest directly in Indian stock markets. QFIs shall include individuals, groups, or associations that follow below mention guidelines:

- Resident in a country that is a member of the Financial Action Task Force (FATF) or a country that is a member of a group which is a member of FATF and
- Resident in a country that is a signatory to IOSCO's MMOU or a signatory of a bilateral MOU with Securities and Exchange Board of India (SEBI).
- A QFI should neither be a person resident in India nor should be registered with the SEBI

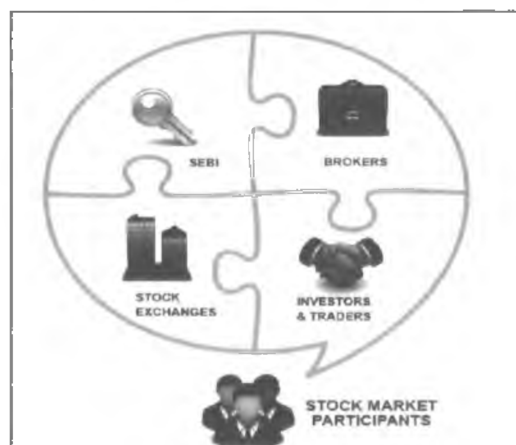
as a Foreign Institutional Investor (FII), sub-account, or Foreign Venture Capital Investor.

- Also, QFI should be set up with a SEBI registered Qualified Depository Participant (QDP) to commence activities. The QDP shall provide inter alia custody services.

Share Markets Work

There are primarily two stock exchanges in India, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). Companies list their shares for the first time in the primary market and in the secondary markets investors can buy and sell their shares during an Initial Public Offering. Any person who wishes to invest in Indian stocks, cannot go directly to the stock markets to buy or sell shares. Buying and selling of stocks have to be done through stockbrokers. A stockbroker is an individual or a financial institute, licensed and authorized by SEBI to trade in stock markets. They also have direct access to the share market. They can act as your agent in share transactions of companies. A stockbroker can also offer additional services like advice on stocks, debentures, government bonds, and listed property trusts, and non-listed investment options. For the services provided, stockbrokers charge a brokerage fee. Also, a stockbroker can plan, implement, and monitor your investment portfolio, conduct research, and help you optimize your returns in stock markets. Having a trading and Demat account is mandatory to invest in the Indian stock markets. The first step is to choose a stockbroker. Next, open a Demat and a trading account in which the stocks would be electronically linked to your portfolio.The trading account is similar to your bank account, which needs to be opened with a stockbroker. This account is used for placing orders in the stock markets i.e. to buy or sell stocks.A Demat account is where stocks are held in a dematerialized form (i.e. electronically instead of physical possession of certificates by investors). It is required to receive or transfer stocks when you buy or sell stocks through your trading account.

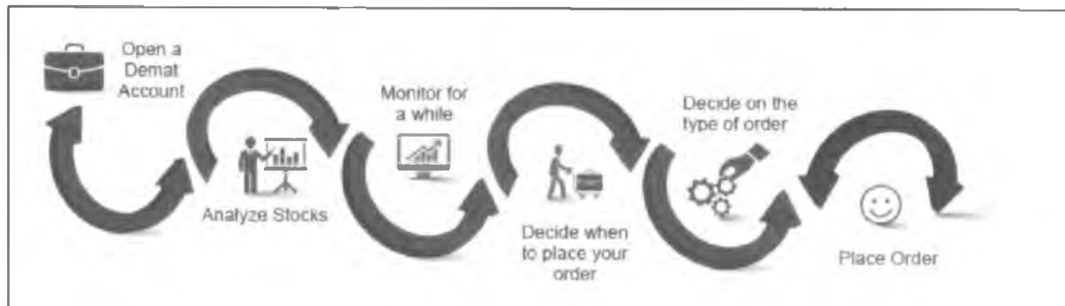
Figure.7: Working of Stock Market



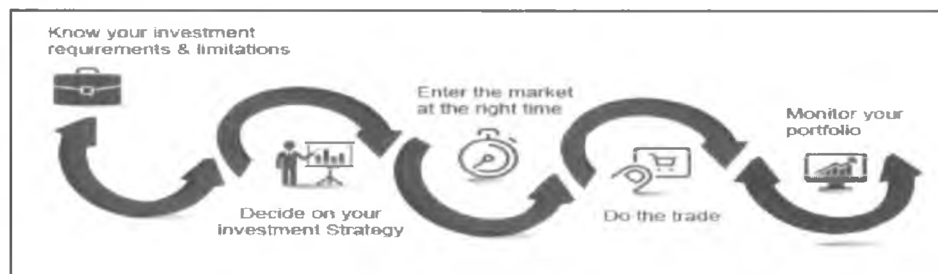
Steps to Open a Trading / Demat Account:

- Approach a stockbroker registered with BSE and NSE
- Fill up the KYC form

- Attach the necessary documents: identity proof and address proof
- Produce the PAN card during the opening of the account
- One canceled cheque of the bank account want to link to trading account and
- Recent passport size photographs.



There is no perfect time to start investing. Also, there is no minimum investment in the share market in India. An investment decision should not be based on market ups and downs or its speculation.

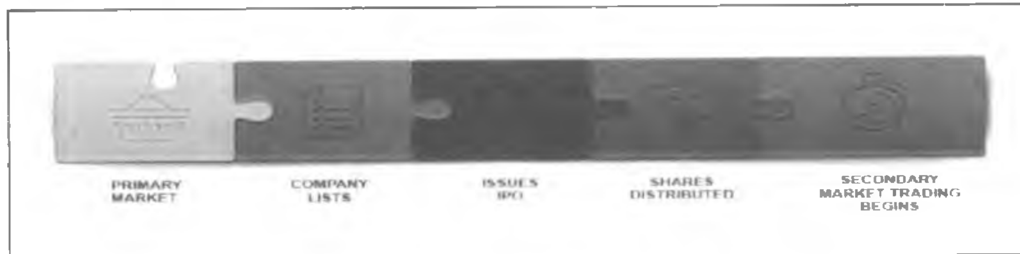


Share Market Works in the Following Order:

- A company gets listed in the primary market through an IPO.
- Shares get distriuted in the Secondary Market
- The stocks issued can be traded by the investors in the secondary market.
- Stock brokers and brokerage firms are entities registered with the stock exchange which offers you to buy particular share at said price
- Your broker passes on your buy order to the exchange, which searches for a sell order for the same share.
- The process takes T+2 days i.e. you will get your shares deposited in your demat account in two working days.

The stock market is one of the largest avenues for investment. As many as Rs. 6 lakh crore-worth stocks have been traded in the two stock exchanges in India on some occasions. Stock

market investing is often called a gamble. It would cease to be a gamble if you understood the basics of the share market. But before starting, one might want to get acquainted with a few market-related concepts.



Avoid investing in a company merely because the stock prices of a particular company are increasing exponentially and make data-backed decisions.

- **Understanding the Stock Exchange Platform**

  A stock exchange is precisely a platform that conducts the trading of financial instruments like stocks and derivatives. The activities on this platform are regulated by the Securities and Exchange Board of India. The participants have to register with SEBI and the stock exchange in order to conduct trades. Trading activities include brokering, issuing of shares by companies, etc.

- **Listing of the Company in the Primary Market**

  A new company is listed in the primary market through the process of an Initial Public Offering, where the company lists details about itself, the stocks it is issuing, etc. The allotment of stocks take place during the process of listing and investors who bid for the stocks get their share.

- **Trading in the Secondary Market**

  Once the company has been listed and issued stocks, these can be traded in the secondary market by the investors. This is the marketplace for the buyers and sellers to transact and make profits or incur losses.

- **Stock Brokers**

  Because of the magnitude of investors who number in thousands, it is difficult to have them assemble in one location. Therefore, to conduct trade, stock brokers and brokerage firms come in the picture. These are entities that are registered with the Stock Exchange and act as intermediaries between the investors and the exchange it self. When you place an order to buy any share at a given rate, the broker processes it at the exchange where there are multiple parties involved.

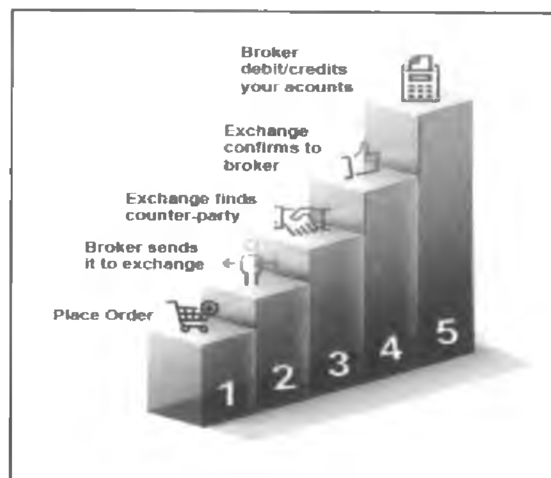
- **Passing of Order**

  Your buy order is passed on to the exchange by the broker, where it is matched for a sell order for the same. The exchange takes place when the seller and the buyer agree upon a price and finalize it; the order is then considered confirmed.

- **Settlement**

  Once you finalize on a price, the exchange confirms the details to ensure that there is no default in the transaction. The exchange then facilitates the transfer of ownership of the shares which is known as Settlement. You receive a message once this takes place. This communication of this message involves multiple parties like the brokerage order department, the exchange floor traders, etc. The settlement time earlier took weeks to materialize which now is done in T+2 days. This means that if you trade today, the shares are reflected in your demat account in two working days time. Investing in the share market is subject to market risks. It is recommended you seek expert guidance before investing. Visit ClearTax to browse through our handpicked mutual funds and pick one based on your suitability.

Figure.8: Processing of Order



Stock Market Related Concepts

Some of the stock market terminology and concepts you would frequently hear with respect to the stock markets are:

- **Dividends**

  A share is a portion of the company and when the company makes profits, you often receive a part of it. This is the idea behind dividends. Every year, companies distribute a small amount of profits to investors as dividends. This is the primary source of income for long-term shareholders - those who don't sell the stock for years together.

- **Market Capitalization**

  Different companies issue varied amounts of shares when they get listed. The value of one share also differs from that of another company's stock. Market capitalization smoothens out these differences. It is the market stock price multiplied by the total number of shares held by the public. It, thus, reflects the total market value of a stock taking into consideration both the size and the price of the stock. For example, if a stock is priced at Rs. 50 per share,

and there are 1,00,000 shares in the hands of public investors, then its market capitalization stands at Rs. 50,00,000. Market capitalization matters when stacking stocks into different indices. It also decides the weightage of a stock in the index. This means, bigger the company's market value, the more its price fluctuations affect the value of the index.

Figure.9: Market Capitalization

- **Rolling Settlements**

A rolling settlement implies that all trades have to be settled by the end of the day. Hence, the entire transaction - where the buyer pays for securities purchased and seller delivers the shares sold - have to be completed in a day.

Supposing your friend agrees to buy a book for you from a bookshop, you will have to pay him for it eventually. Similarly, after you have bought or sold shares through your broker, the trade has to be settled. Meaning, the buyer has to receive his shares and the seller has to receive his money. Settlement is the process whereby payment is made by the buyers, and shares are delivered by the sellers.

In India, we have adopted the T+2 settlements cycle. This means that a transaction conducted on Day 1 has to be settled on the Day 1 + 2 working days. This is when funds are paid and securities are transferred. Thus, 'T+2' here, refers to Today + 2 working days. Saturdays and Sundays are not considered as working days. So, if you enter into a transaction on Friday, the trade will be settled not on Sunday, but on Tuesday. Even bank and exchange holidays are excluded.

- **Short-Selling**

An investor sells short when he anticipates that the price of a stock may fall from the existing price. So, the investor borrows a share and sells it. Once the share price dips, he will buy the same share at a lower price, and return it back, while pocketing a profit in the bargain. Simply put, you first sell at a high and then buy at a low. Short-selling helps traders profit from declining stock and index prices. Since this is usually conducted in

anticipation of a stock movement, short-selling is considered a risky proposition.

- **Circuit Filters and Trading Bands**

  Some stocks are more volatile than others. Too much volatility is not good for investors. To curb this volatility, SEBI has come up with the concept of circuit filters. The market regulator has specified the maximum limit the price of a stock can move on a given day. This is called a price trading band. If a stock breaches this limit, trading is halted in that stock for a while. There are three levels of limits. Each limit leads to trading halt for a progressively longer duration. If all three circuit filters are breached, then trading is halted for the rest of the day. NSE define circuit filters in 5 categories including 2%, 5%, 10%, 20% and no circuit filter.

  Also, prices may not be same on the two exchanges - NSE and BSE. So, circuit filters can be different for shares on the two exchanges.

- **Bull and Bear Markets**

  Markets are often described as 'bull' or 'bear' markets. These names have been derived from the manner in which the animals attack their opponents. A bull thrusts its horns up into the air, and a bear swipes its paws down. These actions are metaphors for the movement of a market: if stock prices trend upwards, it is considered a bull market; if the trend is downwards, it is considered a bear market. The supply and demand for securities largely determine whether the market is in the bull or bear phase. Forces like investor psychology, government involvement in the economy and changes in economic activity also drive the market up or down. These combine to make investors bid higher or lower prices for stocks.

Figure.10: Bull & Bear Markets

- **Margin Trading**

  Many traders trade on the stock market using borrowed funds or secutities. This is called margin trading. It is almost like buying securities on credit. Margin trading can lead to greater returns, but can also be very risky. While it lets you actively seize market opportunities, it also subjects you to a number of unique risks such as interest payments

charged for the borrowed money. Kotaksecurities.com offers its customers the facility of margin trading.

- **Muhurat Trading**

  Every year, the stock market is open for a few hours on the first day of Diwali. A special trading session conducted for an hour on the auspicious occasion of Diwali. Usually this takes place in evening. Mahurat trading has been going on for over 100 years on the Bombay Stock Exchange. It marks the beginning of a new financial year called "Samvat".

- **Top-Down and Bottom-Up Approaches**

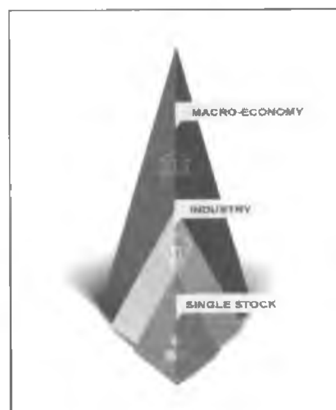
  These are ways to select stocks from amongst the thousands listed on the exchange.

  — The top-down approach first takes into consideration the macro-economy. You understand the trends and outlook for the overall economy. Using this, you choose a one or more industries that are expected to do well in the near future. This is because every industry reacts to overall economic conditions like inflation, interest rates, consumer demand and so on, in a different way. Select one amongst the industries after in-depth analysis. Next, you understand the workings of the industry, the players and competitors and other factors that affect the sector. Based on this, you select one of the companies in the industry.

  — The bottom-up approach is just the opposite. You do not look at the economy or select an industry first, but concentrate on company fundamentals. You first understand what your priorities are - high growth or steady income through high dividends. Using appropriate ratios like the Price-to-Earnings ratio or the Dividend-yield, you select a bunch of stocks. Next, analyze each of these companies; find answers for questions like what factors drive profits? Is the company management efficient? Is the company heavily indebted? What is the future outlook? And so on. Based on the results, select the company that best fits your requirements.

  — The bottom-up approach is most suited for weak market conditions. This is because, the underlying belief is that these companies will perform well even if the economy is poor. They are thus anomalies - companies that don't follow the normal market trend.

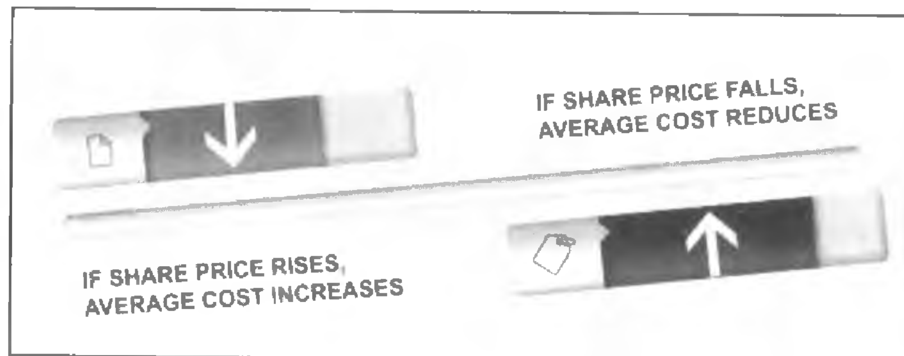
Figure.11: Top-Down and Bottom-Up Approaches



- **Cost Averaging**

  Rupee-cost averaging is a concept when you buy a stock in small bunches, instead of buying in lump-sum. This helps reduce the average cost of investment.

Figure.12: Cost Averaging



This concept comes handy when a stock falls after you have bought it. The fall in share price gives you an opportunity to buy more and reduce your average cost of investment. This way, when you finally sell the shares at some time in the future, you end up making more profits.

- **Stock Volatility**

  Stock prices constantly fluctuate. This is because the demand for the stock changes. As more stocks change hands, greater is the change in its share price. This is called stock volatility. Even the amount of volatility in the market changes on a daily basis. To measure this volatility, the National Stock Exchange introduced the VIX India index, also called the fear gauge. VIX is often used as an indicator of stock price trends. This is because, VIX rises when there is more fear and uncertainty in the market.

- **Price Target & Stop Loss Target**

  As an investor, to maximize your profits, you need to get your pricing right - both when it comes to buying and selling. However, sometimes, prices fluctuate more than expected. So, it can become a little difficult to gauge whether to trade now or wait a little more. This is where stock recommendations help.

  Analysts put out price targets and stop-loss measures, which let you know how long you should hold a stock. A price target indicates that the price of share is unlikely to climb above the level. So, once the share price touches the target, you may look to sell it and pocket your profits. A stop loss, meanwhile, acts as a target on the lower end. It lets you know when to sell before the stock falls further and worsens your loss.

- **Insider Trading**

  Insider trading is 'the trading of shares based on knowledge not available to the rest of the world'. It is illegal to trade after receiving 'tips' of confidential securities information. This applies to corporate personnel as well as traders and brokers. This is why company management have to report their trades to the exchange. For example, when corporate

officers, directors, or employees trade the company's stocks after learning of significant, confidential corporate developments, it is considered an illegal form of insider trading. This applies to employees of law, banking, brokerage and printing firms who were given such information to provide services to the corporation whose securities they traded. Even government employees, who trade after learning of such information, are considered to have broken the law on insider trading. It is a punitive offence.

Conclusion

Emerging markets like India are fast becoming engines for future growth. Currently, only a very low percentage of the household savings of Indians are invested in the domestic stock market, but with gross domestic product (GDP) growing at 7% to 8% annually for the last few years, though in the 6% range for 2018 and 2019, and a stable financial market, we might see more money joining the race. Maybe it's the right time for outside investors to seriously think about joining the India bandwagon.

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