

Fundamentals of Stock Market

Stock Market Basics

Navigating Indian Securities Markets Fundamentals:

Welcome to NSDL Pathshala, your go-to free knowledge source for comprehensive and open stock market and financial education. In a world where financial literacy is crucial, NSDL Pathshala will help you learn the basics of the stock market, why you should invest and who are different financial intermediaries. NSDL is committed to breaking down barriers to knowledge and providing accessible financial education for everyone. There won't be any complicated jargon, just straightforward information to help you understand Indian securities markets.

Q1. What is a Stock Market?

In simple words, the stock market is a place where you can buy and sell securities. The main purpose of the stock market is to help the buyer and seller of securities meet. It serves as a platform for companies to raise money and individuals and institutions buy and sell ownership shares in publicly traded companies.

Q2: Why do Investors Buy Shares?

Well, buying shares of a company provides investors with a share of ownership in that company. If the company performs well, the share price is likely to increase, allowing investors to make a profit when they sell them. Additionally, some companies distribute a portion of their profits to shareholders in the form of dividends. This could be another source of income for shareholders. However, it's important to note that if the company underperforms, the value of your stock may decrease, posing a risk to the investment.

Q3: Is the Stock Market and Stock Exchange the Same?

Stock market is the entire ecosystem of buying and selling shares and other financial instruments. It reflects the combined activities of different market participants. On the other hand, stock exchange is a regulated marketplace where securities are listed and traded. It's a platform where buyers and sellers come together and execute trades. In India, stock exchanges are run as per the regulatory standards set by SEBI.

The two main stock exchanges in India are:

- Bombay Stock Exchange (BSE)
- National Stock Exchange (NSE)

Q4. How Can I Buy Shares on the Stock Exchange?

Shares are listed and traded on exchanges. However, you need the services of an intermediary to buy them. To facilitate your transaction, you need to deal with a SEBI registered broker.

Q5. What is the Role of a Stockbroker?

This intermediary is authorised to buy and sell shares and other securities based on the investors instructions. . They charge fees or commissions for their services. In India, stockbrokers need to be registered with SEBI.

Q6. Why do Stock Prices Fluctuate?

It's hard to pinpoint a single factor that affects the share prices as the share market is quite dynamic with multiple factors working together. Some of the key factors that can move share prices:

- Company performance
- News and global events
- Economic indicators
- Market sentiment
- Industry trends
- Interest rates
- Regulatory changes
- Corporate actions
- Technological advances
- Natural disasters
- Market supply and demand mismatch

Q7. What Happens After You Own a Share?

Once you own a share, you become a shareholder in the company. The more shares you own, the larger the percentage of ownership. Owning a share means, you get

- **Voting Rights:** Depending on the type of shares you own (common or preferred), you may have the right to vote on certain resolutions of the company.

- **Capital Gains or Losses:** The price of your stock can change based on market conditions and the performance of the company.
- **Decision-making Influence:** You may have the opportunity to participate in major corporate decisions, such as mergers and acquisitions or changes to the company's charter.
- **Company Updates:** You will receive regular updates and reports from the company, including annual reports and financial statements.
- **Corporate Actions:** Stock splits, reverse splits, stock buybacks and merger and acquisitions are some corporate actions that affect the price of your stocks.

Q8. How are Stocks Traded on Stock Exchanges?

Investors access stock markets through a stockbroker electronically. However, there are various market intermediaries within the stock markets who play important roles in executing trade transactions. Here's the stepwise process that explains the working of different entities:

Step 1: Investors Initiate Trade Through Stockbroker: Investors start the stock trading process by placing buy or sell orders through their stockbroker.

Step 2: Order Placement: Once the order is placed, the stockbroker matches buy and sell orders. It is at this stage that the trade takes place.

Step 3: Clearing: After execution, the Clearing Member steps in to ensure trade settlement. Clearing involves verifying trade details and ensuring both parties have the necessary resources.

Step 4: Settlement: Settlement follows, involving the actual transfer of ownership and funds to complete the transaction. After the settlement, the investor's stock ownership information is updated in the depository system such as NSDL. Depositories keep a centralised record of all stock ownership changes.

Q9. How to Calculate Returns?

Returns on an investment can be calculated using the formula:

Return = $(\text{Current Value} - \text{Initial Investment}) \times 100$

Initial investment

Let's say you invested Rs. 10,000 in a stock, and after one year, the value of your investment increased to Rs. 11,200.

Using the formula, in this example, your return on investment is 12%.

This means that your investment has appreciated by 12%.

Q10. Are Traders and Investors the Same?

Often the words traders and investors are used interchangeably. But there are some fundamental differences. Investors typically hold stocks share for an extended period, embodying a long-term approach. On the other hand, a trader is more responsive to the market's fluctuations. The trader prefers short-term investment and aims to gain from price fluctuations.

Q11. What are the Different Types of Investors?

There are different types of investors in the market with different approaches to selecting stocks, risk tolerances and investment goals.

Here are two common types of investors:

- **Growth Investors:** These investors seek opportunities in industries or markets experiencing rapid expansion, often driven by the development of new technologies and services.
- **Value Investors:** These investors look for stocks that they believe are undervalued due to, say short term market sentiment. They identify strong companies, regardless of their growth or maturity phase, that have experienced significant declines in their stock prices. Their aim is to capitalise on the market's short-term pessimism, ultimately selling the stocks once the price goes up.

Importance of Investment

Understanding Different Class Assets and What You Should Know Before Investing

1. Why Should You Consider Investing in Shares

Investing your money in shares can be a smart move to beat inflation. While your monthly expenses may remain the same, the increasing inflation will make you shell out more money for the same commodities. With passing years, inflation reduces the purchasing power of your money. This is why investing strategically in the shares market can help you make your money work for you and protect your financial future against the effects of inflation:

- **Historical Returns:** Historically, it has been seen that when inflation goes up, so does the market price of value stocks. Although there are market fluctuations, expanding your returns on your savings can help you grow your purchasing power, keeping in pace with inflation.
- **Ownership in Profitable Companies:** When you invest in stocks, you acquire a share of ownership of companies. Profitable businesses often have the ability to adjust their prices and revenues to ride the wave of inflation. The increasing value of stock can act as a shield against inflation.
- **Dividend Income:** Many well-established companies distribute a part of their profits with shareholders in the form of dividends. In simple words, it's like getting a paycheck for owning stocks. In times of inflation, this extra income stream can be beneficial.

2. Why Diversification is Important

When it comes to investing, there are various financial instruments to choose from. But as the old saying goes, you should not put all your eggs in one basket. Meaning holding different types of assets can help reduce the risk. This is known as diversification in investment. It's like having a mix of all different investments in your basket. What's the point of doing so? The goal is to reduce the risk that a particular asset may be facing at that time. A diversified portfolio will ensure that if you are losing money somewhere, you are also gaining some from elsewhere.

3. What You Should Know Before Investing

Getting started as an investor can be quite exciting. However, investing without having a plan may leave you susceptible to making impulsive decisions. To navigate the complexities of the financial market, you need a methodical approach. Here are some things you should know before investing:

- **Know Your Financial Goal:** Different people want different things from life. Understand your short-term and long-term financial goals that you wish to achieve and create a financial plan. Your financial plan should be a living document that should be reviewed and changed, taking into account changes in income, expenses, family dynamics and market conditions.
- **Do Not Invest in Something You Don't Understand:** Different asset classes work differently. It is best to invest only when you understand these asset classes and the risks associated with them.
- **Assess Your Risk Tolerance:** Every investor has a comfort zone and risk tolerance level. Remember, higher the returns, higher the risk. Evaluate your risk tolerance level, it will save you from unnecessary stress.
- **Know the Investment Timeframe:** Each investment product exhibits varying performance patterns over time. Choose investments that match time frames of your financial goals. For instance, saving for a child's education requires long-term planning whereas an international holiday is a short-term goal.
- **Never Invest Borrowed Money:** Investments of all sorts come with inherent risks. Profitability is not always guaranteed. Hence, it is important to invest funds that you have.

Role of Financial Intermediaries

Understanding Key Players That Make the Stock Market Work

In the stock market, financial intermediaries play an important role in connecting investors with the market. Not just that, they collectively ensure that the market functions smoothly and as per the rules and regulations set by SEBI. Who are these financial intermediaries? Well, for instance, individual investors who want to buy shares will engage SEBI registered stock brokers. But stock brokers aren't the only financial intermediary. There are several intermediaries such as depository participants, Banks and MIs such as stock exchanges & depositories.etc that facilitate the functioning of the securities market.

What are Financial Intermediaries?

Stockbrokers: Stockbrokers are one of the most important financial intermediaries as they execute buy and sell orders for stocks and other assets on behalf of investors. They also offer guidance and support in making investment decisions for both individual and institutional investors. Stockbrokers are like your single-point of contact for investors. Stockbrokers need to be registered as a trading member with the stock exchanges and possess a valid licence. They function within the regulatory framework set by SEBI.

The role and services of stockbrokers:

- Offer you access to markets and enable transactions.
- Offer help with either phone-based trades or trading software or platform.
- Issue contract notes to confirm daily transactions.
- Facilitate securities transfers from demat account and fund transfer from bank account.

Note: Stockbrokers charge fees, known as the 'brokerage charge,' for the services they provide. Brokerage rates vary from one stockbroker to another. Some charge a flat fee whereas others take a percentage of the value of the securities traded.

Types of Stockbrokers

- **Full-service Brokers:** These brokers offer a wide range of products and services to their clients. Besides securities trading, they offer guidance on personal investment, retirement planning and portfolio management. They also share their expertise on capital gains taxes with the clients to give them personalised service. They charge a significant fee for the breadth of services they offer.
- **Discount Brokers or Online Brokers:** In contrast to traditional full-service brokers, discount or online brokers offer internet trading services at a reduced cost. These brokers typically provide clients with access to a no-frills trading platform. They charge lower brokerage fees as compared to full-service brokers. Investors who oversee their assets on their own prefer discount brokers to reduce their trading costs.

Depository Participants

Just like you keep your money safe in the banks. Similarly, a depository is a special financial institution that keeps your securities, bonds and stocks secure in the electronic form. It eliminates the need for physical certificates and allows electronic book-entry transfers, making transactions safe and secure. For instance, NSDL is a depository. It is among the world's largest depositories and has an advanced infrastructure to manage a significant portion of securities settled in dematerialised form.

However, you cannot directly open accounts with NSDL. For that, you have to go through depository participants. When you open a demat account with a depository participant, you gain access to the services offered by the main depository. In simple words, you have to contact a DP to open a demat account.

Investors pay a certain fee to open an account with a DP.

Functions of DPs:

- They facilitate the opening of demat accounts for investors.
- They convert physical share certificates into electronic or demat form.
- They also assist investors in converting electronic securities back into physical certificates if required. This is known as rematerialization.

- They securely hold and maintain investors' electronic holdings in demat form.
- They play a crucial role in settling trades by facilitating the transfer of securities and funds between buyers and sellers.
- They help investors to pledge their demat securities as collateral for loans and assist in the process of unpledging when needed.
- They facilitate the transfer of demat securities between different demat accounts, either within the same DP or across different DPs.

Banks: Investment banks assist companies in getting money by handling initial public offerings (IPOs) and launching new securities. They also offer advice for mergers and acquisitions. As far as investors are concerned, banks assist in transferring funds from your bank to your trading account.

Clearing Corporations: Clearing Corporations are entities responsible for confirming, settling and delivering transactions. In India, there are two clearing corporation --- each of them is wholly owned subsidiary of National Stock Exchange and Bombay Stock Exchange respectively. These settlement bodies are regulated by SEBI. Investors do not need to directly interact with these bodies.

Who is the Regulator of Financial Intermediaries in the Securities Market?

In India, the primary regulatory body overseeing financial intermediaries in the stock market is the Securities and Exchange Board of India (SEBI). SEBI oversees and regulates stockbrokers, depository, depository participants and clearing members.

Understanding IPOs

Demystifying IPOs: What Every Investor Needs to Know Or, A guide to what is an IPO and what happens afterwards

If there's one thing that a business cannot function without -- it is the capital. All businesses, regardless of their size, need capital to finance their operations. Initially, all businesses start off as private entities. However, as they grow some companies often become publicly traded companies to raise capital for their businesses. Here we share with you in detail what an IPO is, why companies go public and how does it work:

What is an IPO?

In simple words, an Initial Public Offering (IPO) means a privately-owned company makes its shares available on stock exchange for the general public to trade. This act of issuing shares makes the privately-owned company a public company. IPO presents investors opportunities to buy shares and generate a return on their investments. However, it must be noted that risks and returns go hand in hand.

Why do companies issue an IPO?

Companies issue an IPO for various purposes. Some of the common objectives are to:

Infuse new equity capital into the business

Streamline the trading of its assets

Generate capital for various financial needs.

Convert the investments of private stakeholders into monetisable assets.

Can any private company issue an IPO?

Not every company can issue an IPO. In India, when companies decide to go public and have their shares traded on stock exchanges, they need to be fit as per the specifications laid out by SEBI. Eligible companies need to follow the SEBI-mandated process. Once SEBI verifies and approves the application, then only can the company announce a date for its IPO.

Types of IPO

Fixed Price Offering: A Fixed Price Offering in an IPO refers to the predetermined issue price at which a company chooses to release its shares to the public. The issue price is fixed and investors need to pay the full price of the shares when making the application.

Book Building Offering: In this, the issuing company presents a price range of 20% within which investors can bid for the stocks. Prospective investors participate by placing bids on the shares before the ultimate price is fixed. In this process, investors need to indicate both the quantity of shares they wish to buy and the price they are ready to pay per share. The final price of the share is determined by investors' bid.

For how many days does the IPO open?

As per stock exchange rules, the subscription period is required to be open for a minimum of three working days but should not exceed ten working days.

What happens after the IPO?

Once the IPO is issued, the shares of the company are available for trading in both the primary and secondary markets. Here's what you need to know about each market:

Primary market: In the primary market, the IPO takes place and new shares are issued directly by the company to the public. Investors buy shares directly from the company. The money from these sales goes to the company. This is the phase where the company raises capital for its corporate purposes.

Secondary market: The secondary market is where existing shareholders buy and sell shares among themselves. The company itself does not receive any funds from these transactions; instead, they occur between investors.

Planning to buy shares in the IPO? Here are some dos and don'ts

An IPO is an exciting opportunity for companies going public as well as investors. If the company debuts above the offer price, initial investors stand to gain. Buying shares in an IPO gives investors shareholder status, offering voting rights in the company's AGMs. On the other hand, in the

absence of any historical data, it's hard to predict whether an IPO will perform well or not.

Here are some dos and don'ts for investors:

Dos:

- Understand the company's business model, financials, industry, and growth prospects.
- Go through the prospectus for detailed information about the company.
- Evaluate the company's management team.
- Look at the overall industry trends
- Compare the IPO's valuation with its competitors
- Maintain a diversified portfolio
- Be aware of any lock-up periods that restrict investors from selling their shares after the IPO

Don'ts:

- Don't invest in an IPO without thorough research.
- Don't ignore risk factors. Be aware of the risks associated with the company's business and market conditions.
- Don't invest only because of hype or speculation.
- Don't invest more than you can afford to lose.

Exploring Stock Market Indexes

A Beginner's Guide to Stock Market Indices : Why Stock Market Indices Matter to Investors and Other Market Participants

Is the market going up or down today? Well, if you want to know the pulse of the market, monitoring market indices is the best way to do that. But what exactly is a market index? In simple words, a stock market index is like a scorecard that tells us how well the market is doing. There are performance trackers for the entire market as well as certain segments. So, when people talk about the stock market going up or down, they often look at these market indices to understand what's happening.

What Does the Market Index Track?

The market index keeps an eye on the price movements of stocks. If the prices of the stocks are going up, it's a sign that the market is doing well and vice-versa. Market indexes give you a broad idea of a portfolio of investment holdings. An ideal index is like the mood-reader of the market.

Are all the Market Indexes the Same?

It would seem that two indexes following the same market would show the same results. However, that's hardly the case. The reason being each index uses a particular methodology to gauge the performance of the market. It's like two people are watching a cricket match but they are focusing on different players or aspects, so their observations end up a bit different. Similarly, these indexes report different results of the same market.

How Many Indexes Exist in the Indian Stock Market?

Well, the Sensex and Nifty are the main stock market indices. They are the benchmark indexes. This means that they are the standard point of reference for the market.

- **BSE Sensex:** Popularly called just Sensex, it is a market index that reflects the performance of companies listed on the Bombay Stock Exchange. This index is calculated using a method called free-float market-weighted methodology. Here, only shares of a company that are available for trading are taken into consideration. Shares that are

held by promoters or governments, are not considered for calculation.

- **Nifty 50:** It gives us a quick look at how the entire market is doing. Just like Sensex, Nifty calculates its index using a method called free float market capitalization weighted index. Nifty 50 is owned by NSE Indices, which is a part of NSE Strategic Investment Corporation Limited. It's like a market report card for key companies, helping investors and analysts understand the overall market trends.

Note: The Sensex and Nifty gauge the overall market performance. However, there are several other sectoral indices that evaluate the performance of specific sectors.

Why are Market Indices so Important?

You may ask what purpose these indices serve. Well, these indices are important for several reasons. Some of the reasons are:

- **Provide Important Information for Benchmarking:** Traders, investors, and other market participants often use index performance as a benchmark to understand how the market is faring. Sensex and Nifty provide the benchmark to which you can compare the performance over a specific period.
- **Help in Portfolio Management:** Both Nifty and Sensex represent how stocks across various sectors are performing. Investors can use these indices to diversify their portfolios. When investors mirror the sectoral distribution of these indices, they can have a portfolio that is balanced and diversified.
- **Offer Sectoral Exposure:** Nifty and Sensex comprise stocks from different sectors. This gives investors sectoral exposure, allowing them to align their portfolio with the market's sectoral distribution. This also prevents investors from focusing on one industry when it comes to their investments.
- **Help Investors / Traders with Decision-making:** Of all the market participants, traders are the ones who keenly closely watch every movement on the stock market. Intraday traders and day traders make everyday trade decisions based on economic outlook which is understood from market indexes.

What are Sectoral Indices?

Sectoral indices are market indicators that focus on tracking the performance of specific industry sectors. Instead of covering the entire market, these indexes concentrate on particular segments of related industries. For instance, Nifty Bank reflects the performance of Indian banks whereas Nifty Pharma shows how the pharmaceutical and healthcare-related sector is doing.

What are Market-cap Based Indices?

These indices show the market value of listed companies . For example, BSE and NSE Small Cap 50, consist of companies with lower market capitalisation, in accordance with SEBI rules.

Clearing and Settlement Procedure

Buying and Selling Stocks Online: Understanding T+2 System in India

What Happens After You Buy or Sell Stocks

Buying and selling shares have become quite straightforward these days. With a few clicks, investors can buy and sell shares. However, it may seem that after they click buy or sell, the stocks appear or get debited as the case be. However, this isn't the case on Indian stock exchanges. In India, stock settlements follow a T+2 system, indicating that the completion and finalisation of all stock transactions occur two business days after the trade day (T day). Here we explain what happens after stocks are bought.

Day 1 (T Day): On Day 1, you buy X number of shares of Y company. Your broker debits this amount and provides a detailed contract note. This day is also known as the Trade Day (T day).

Day 2 (T+1): Although you have the option to sell the stocks in a quick trade called "Buy Today, Sell Tomorrow", the stocks are not yet in your demat account. This poses the risk of selling stock you don't officially own. Note: If you're new to trading, avoid 'buy today, sell tomorrow' trades unless you fully understand the risks involved.

Day 3 (T+2): When the brokerage firm officially receives the shares, it credits the same to your demat account. Meanwhile, the money is credited to the seller. The shares are reflected in your demat account by the end of T+2 day. What happens when you sell a stock?

Day 1 (T day): When you sell stocks, it's called the trade day or 'T Day.' Right after you sell them, those particular stocks are temporarily blocked.
T+2 day: Before the T+2 day, these blocked shares are sent to the stock exchange. On T+2 day, you'll receive the money from the sale. However, the amount you receive will be after deducting all the necessary charges.

Why Does Share Settlement Take Time?

Here are some common reasons why share settlement takes time:

- **Unavailability of Shares:** You might buy some shares, but it is not necessary that they are readily available for sale. A seller or multiple

sellers need to make those accessible. This happens more often with big companies or popular stocks.

- **Settlement of Dues:** Your broker is waiting for you to settle fees related to trading on your demat account. These fees usually don't stop the transfer of shares. However, if there are accumulated charges, the broker might delay adding shares to your demat account.

Impact of Corporate Actions

Stay ahead of the curve: Understanding corporate actions and their implications

From market conditions to industry trends, from global events to regulatory changes, many things affect your investment portfolio. One thing that has a direct impact on the value of your shareholdings is corporate actions. What exactly are corporate actions? In simple terms, these are actions that are initiated by publicly traded companies. These actions could range from everyday operations to significant strategic decisions. Corporate actions need the approval of the company's board of directors. Some corporate actions also need authorisation by shareholders through voting.

Why does knowing about corporate actions matter?

By staying informed about upcoming corporate actions and their potential implications, as investors, you can make more informed decisions about the companies they have invested in. Insights about corporate actions help you to assess how these might affect the stock value and dividend payments among other things. An understanding of corporate actions helps you to tweak your investment strategies accordingly.

How to keep a tab on corporate actions?

You can find information about corporate actions of a company on their websites. Typically, companies announce corporate actions through press releases and regulatory filings. Stock exchanges such as BSE and NSE may also provide information about corporate actions on their websites. Annual reports also mention the details of past and upcoming corporate actions.

Common corporate actions are:

- **Dividends:** When companies make profits, they share a percentage of the same with shareholders. These profit-sharing payments are called dividends. The percentage of the dividend is determined by the company's board of directors and is typically distributed quarterly. Shareholders either receive cash or have the option to reinvest the same to buy additional shares.
- **Bonus Issue:** When a company offers additional free extra shares to its existing shareholders, it's called a bonus issue. Instead of

increasing the dividend payments, companies opt to distribute additional shares to their shareholders. This not only rewards the existing shareholders but also encourages more investment.

- **Stock split:** A stock split is when a company decides to increase the number of shares available by lowering the price of each share. For example, if you had one share worth ₹1,000. After the split, you might have two shares worth ₹500 each. Even though you now have two shares, the value of your holdings remains the same. The splitting makes the shares more affordable for investors and this may create an opportunity for more investors to buy shares in the company.
- **Rights issue:** A rights issue is when existing shareholders are offered the opportunity to buy additional new shares. However, unlike bonus issues, these additional shares are not available free of cost. Rather shareholders can buy additional shares at a price lower than the market rate within a specified period. Companies issue a rights offering as a means to raise additional capital.
- **Buyback of shares:** As the name suggests, a buyback of shares is when a company decides to buy its own shares from existing shareholders. The company can buy the shares back either by issuing a tender offer or through the secondary market. Usually, the company buys shares when their price is higher than the current market price. There are different reasons why companies buy back their shares. It could be to offset dilution and increase the voting rights of the board of directors. It could be because the board of directors feel that the shares are undervalued in the market.