



CAPITAL MARKETS WEEK

Dates

July 22-28, 2017

Theme

Capital Market of New India : The Reform Agenda
for Inclusive Growth



**THE INSTITUTE OF
Company Secretaries of India**
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament

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Financial Sector towards the Growth of Indian Economy: Role of Company Secretaries as a Professional Implementer

CS Mahavir Lunawat*

In the contemporary perspective, Indian economy is considered as the one of the fastest growing and emerging economies in the world. Contributing to its high growth are many critical sectors including Agriculture, Banking, Industry, Capital Market, Money Market, Financial Services and many more. Among all, the ‘financial services sector’ is unarguably one of the most distinguished sectors of Indian economy.

Indeed, the development of any country depends on the economic growth, the country achieves over a period of time. Economic growth deals about investment and production and also the extent of Gross Domestic Product in a country. Only when this grows, the people will experience growth in the form of improved standard of living, namely economic development.

This confirms the very fact that the role of financial sector in shaping fortunes for Indian economy has been even more critical, as India since independence has been equally focussed on other channels of growth too along with resilient industrial sector. This prompted India to depend on other sectors for its sustenance. These other sectors mostly constituted of ‘agricultural sector’ and ‘financial services sector’.

As the financial sector along with financial services sector plays a significant role in the economic empowerment and global growth of the country, a balanced and vigil regulation to ensure the transparent run of these sectors while avoiding any tantamount of fraud and malpractices injurious to the interest of investors, stakeholders and country as a whole is equally vital.

Therefore to regulate the conduct and day to day affairs of financial sector, a robust regulatory regime has been established in India along with the instituting various regulators to regulate the varied factors of financial sector. Few major regulatory bodies include, Reserve Bank of India, Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India, along with the control and direction of Ministry of Finance and Ministry of Corporate Affairs. It assures that:

- Where a robust economy is vital to the growth of nation,
- Financial sectors is vital to the growth of economy,

* Chairman, Financial Services Committee & Central Council Member, The ICSI . The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

- Balanced Regulatory Regime is vital to the growth of Financial Sector,
- Thorough and adequate compliances and governance is vital for Balanced Regulatory Regime,
- When it comes to compliance and governance, Company Secretaries as a proficient governance professionals are responsible and vital for Balanced Regulatory Regime and therefore playing significant role in leading the inclusive development of the nation.

This makes us to have a call in thoroughly analysing the professional role of CS in the financial sectors of the country and how the financial services provided by the Company Secretaries contributes proficiently towards the inline regime of compliance and governance in Balanced Regulatory Regime of financial sector of the country.

Recognition of Company Secretaries in Financial Services

“Leadership is the capacity to transform vision into reality.” Warren G. Bennis

Former President of India Dr. APJ Abdul Kalam has said that every leader must have a vision and also have passion to realize the vision.

A profession is all about appropriate response to situations. If this response could be standardized, this can be programmed and can be delivered by machines or technicians. The forte of the professionals is that what can't be programmed for the time being and what requires application of mind, of course, ethical application of mind.

The emerging regulatory paradigm is certainly demanding and would be more demanding with the passage of time. The Service Sector is now open and it will require us to look beyond traditional and conventional opportunities to focus on a larger canvas in a wider perspective.

Value addition and stakeholders' wealth maximization will be the key 'mantras' to sustain the growth momentum in the market place. Multi-tasking and versatile knowledge would be the required skill sets to reach the pinnacle. Therefore a new orientation in our thinking, perception and actioning is a call.

The profession of Company Secretaries needs to evolve to meet the challenges of a more dynamic business and regulatory environment. The Companies Act, 2013, SEBI Listing Regulations, 2015 and the GST regime etc. depict significant improvements in the corporate sector operations and cast huge responsibility on Company Secretaries.

The great American leader Dr. Martin Luther King Jr. once remarked, “The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of challenge and controversy”. If you strategize, plan and are willing to embrace change, then you will be able to acclimatize the changing business milieu. Being flexible allows a professional to react proactively and guiding the entities response to changes without being paralyzed with fear and uncertainty.

The future winners will be those professional who escape the gravitational pull of the past and ride on the fuel of innovation, adaptability and clear conscience. Opportunities under the new legislations are galore, but there are also Challenges. To be successful, one should be adaptable to situations that makes learning and unlearning easier.

It is very rightly quoted by Noble Laureate *Ms. Malala Yousafzai* “Let us make our future now, and let us make our dreams tomorrow's reality” but “All you need is the plan, the road map, and the courage to press on to your destination” as said by *Earl Nightingale*.

The distinct proficiency of the Company Secretaries in compliance and governance has made them to acquire recognition under numerous laws pertaining various areas of economic, technological, political and social reforms too.

Out of many, a snap shot of the recognition of the Company Secretaries professionals could be seen as below:

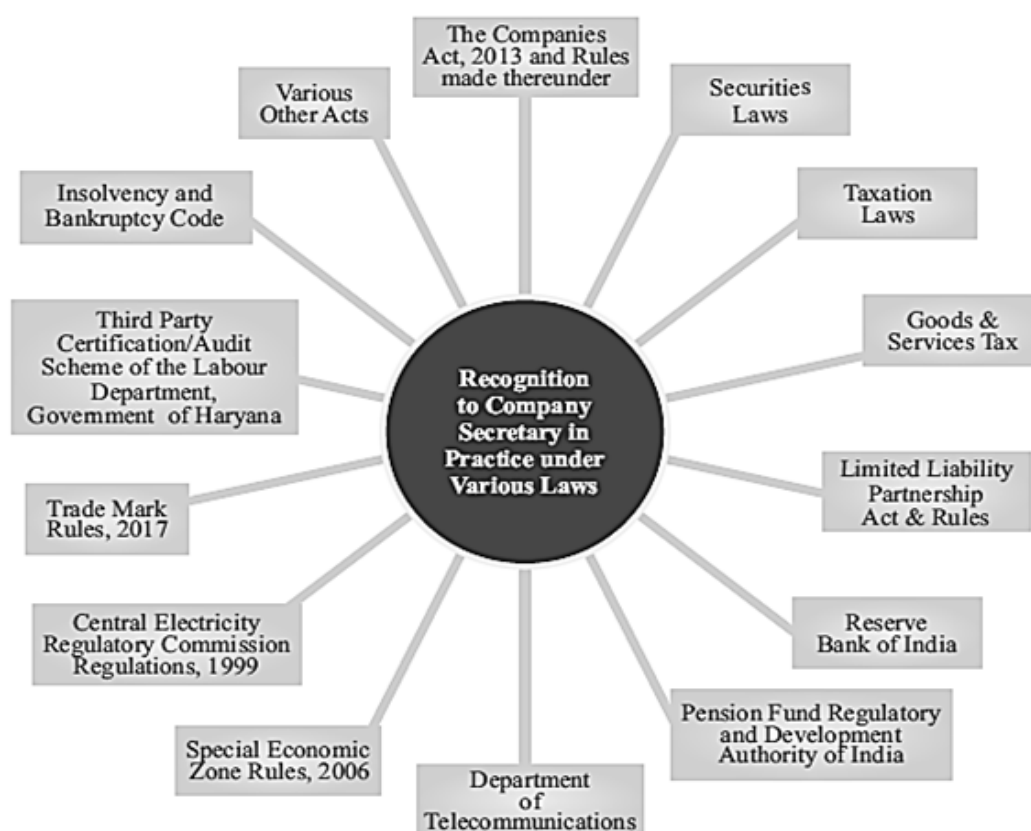


Figure 1 Source: Areas of Recognition to the Company Secretary in Practice under various Laws, ICSI

Role of Company Secretaries in the Financial Sector

Since the very inception of the Profession of Company Secretaries, the professional commune is persistently coming forward while establishing their expertise and specialization in varied areas of compliance and governance. With the significant role, company secretaries are playing as the dedicated governance professionals, it would appropriate to mention that with

transforming India, role of Company Secretaries has also be transformed in setting the advanced parameters of effective and justifiable governance throughout the nation.

With the renovation and transformation of regulatory regime in the direction to settle the regime of sustainable governance in India, Company Secretaries as the Governance Professionals are endowed with more advanced role not only in utilizing the opportunities for the further advancement of the profession, but also to contribute their expertise in making India, an established super power with growth to all at global fora.

Among all, there role in the financial service sector seems to be invincible. It would nearly take to write a book on the expert role of CS in the financial service sector, yet their role under few major heads can be analysed as below:

Role of Company Secretary under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

The SEBI initiative of notifying the 'Listing Regulations' in the wake of transparency and disclosure is a welcome move in this direction. As we know that, SEBI has been the pillar of Indian capital market. SEBI as the nodal agency for capital market regulation in India is continuously coming out with new regulations and guidelines for keeping pace with the development of international capital markets and one of the step moving forward ahead is SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) notified on September 2, 2015 which is already effective from December 01, 2015. Company desirous of listing its securities shall enter into a listing agreement with the stock exchange. Existing listed entities are required to execute a fresh listing agreement within 6 months from date of notification of SEBI Listing Regulations. For execution of all these, on October 13, 2015 SEBI came out with the new format of uniform listing agreement.

The LODR Regulations provide much emphasis on disclosure and transparency. For instance, companies are subject to a mandatory filing requirement on the stock exchanges through the electronic platform. Other information mechanisms such as annual information memorandum are addressed. There is also a great deal of emphasis on investor redressal. The LODR Regulations also incorporate several other procedural matters that have hitherto been addressed in the listing agreement. The disclosure requirements have been increased manifold in tune with form 8k of US listing regulations. Apart from prescriptive requirements (**deemed material events**) there is a qualitative list of events which have to be tested for their price sensitivity. **KMPs shall be authorised by the Board for this purpose.** Deemed material events include downstream direct or indirect investment s being 5% or more of the Capital of the investee.

Further, this regulation has raised the bar for the profession of company secretary, the recognition of company secretary as Compliance Officer is ample testimony to the fact that we have arrived. Being one of the key persons in the company is really challenging. Now the actual onus of compliance is on the compliance officer. Company Secretary is looked upon by the regulators, as ethical and trustworthy professional whose professional judgment and competence has made a mark in the corporate sector.

Role of Company Secretary under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

The recognitions to Company Secretary/ Company Secretary in Practice under the Listing Regulations are as under:

1. Regulation 6 provides that a listed entity shall appoint a qualified company secretary as the compliance officer.
2. Regulation 7 (3) requires that the listed entity shall submit a compliance certificate to the exchange, duly signed by both the compliance officer of the listed entity and the authorised representative of the share transfer agent, wherever applicable, within one month of end of each half of the financial year, certifying that all activities in relation to both physical and electronic share transfer facility are maintained either in house or by Registrar to an issue and share transfer agent registered with SEBI.
3. Regulation 40 (9) requires that the share transfer agent and/ or the in-house share transfer facility, as the case may be, produces a certificate from a practicing company secretary within one month of the end of each half of the financial year, certifying that all certificates have been issued within thirty days of the date of lodgement for transfer, sub-division, consolidation, renewal, exchange or endorsement of calls/allotment monies.
4. Regulation 56 (1) (d) provides that a half-yearly certificate regarding maintenance of hundred percent asset cover in respect of listed non convertible debt securities, by either a practicing company secretary or a practicing chartered accountant, along with the half yearly financial results.
5. Schedule V, Clause E requires compliance certificate from either the auditors or practicing company secretaries regarding compliance of conditions of corporate governance to be annexed with the directors' report.

Role of Company Secretary under Companies Act, 2013

The Companies Act, 2013 has catapulted the profession to newer heights. With many instances of fraud, corruption and mismanagement, the new enactment is the governance bible. Relying on sturdy shoulders of governance professional; it signals a new age; proper execution shall define the ambit. The dominant theme of Companies Act is self-regulation. The principal responsibility in this regard has been entrusted on the Company secretary, who has been given an alleviated position in the corporate hierarchy.

The Act provides substantive oversight role to the company secretary. For the first time the functions of the Company secretary are codified to include reporting on compliance with the provisions of the Companies Act, 2013, the rules made there under and other laws applicable to the company. This in itself is a huge responsibility for the company secretary to rise to the expectations of the company and the regulators. Further the rules provide that it is the duty of the Company Secretary to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers; to assist and advise the Board in ensuring good corporate governance and in

complying with the corporate governance requirements and best practices; to assist the Board in the conduct of the affairs of the company.

Rule 8A of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provide for appointment of Company Secretaries in a company other than a company covered under rule 8 which has a paid up share capital of five crore rupees or more shall have a whole-time company secretary.”

This in itself enhances the avenues for budding Company secretaries.

Further the Act has recognised Company Secretary as a Key Managerial Personnel along with the Chief Executive Officer/managing director/manager, whole-time director and Chief Financial Officer is ample testimony to the fact that we have arrived at being the key person in the company.

The Companies Act also makes it mandatory for every company to observe such Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India thereby giving them statutory recognition. The Act casts duty on the Company Secretary to ensure that the company complies with the applicable Secretarial Standards thereby enhancing the role of Company Secretaries. Further the Companies (Management and Administration) Rules, 2014 provide that Report on Annual General Meeting shall contain the details in respect to confirmation with respect to compliance of the Act and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting.

- It is further important here to understand the role and responsibilities bestowed by the new Act. These include the following:
 - As a major responsibility a CS has to sign the financial statement, including consolidated financial statement of a company, where the CEO is a director of the company.
 - As a KMP A CS has been prohibited from insider trading/forward dealing in securities, which has stringent penalty for contravention.
 - For all the purposes under the Act, a KMP is now a related party which has far implications.
- Signing of Annual Return – a CS whether in employment or in practice has to sign/certify Annual Return of a company, which makes the return a complete report on the governance structure of a company.
- Secretarial Audit is the complete expression of faith of the legislature and government on the profession to instil corporate discipline and ensure that laws of the land are complied with.
- Duty to report fraud:
 - o A very significant duty has been cast on the company secretary in practice under section 143 (12) the Companies Act, 2013. It provides that if the company secretary in practice, in the course of the performance of his duties as secretarial auditor, has reason to believe that an offence involving fraud is being or has been committed

against the company by officers or employees of the company, he shall immediately report the matter to the Central Government.

- The Act has also recognised company secretary as an “expert“. The role and liability of an expert have been emphasised under various sections viz.
 - o section 26, 35 & 388 regarding prospectus,
 - o an expert may be part of the Mediation and Conciliation Panel maintained by central government for the purpose of Mediation & Conciliation between the parties during the pendency of proceedings before Central Govt./NCLT/NCLAT under section 442,
 - o for the purpose of valuation report with respect to mergers & amalgamations under section 232,
 - o an expert can also be a part of The Serious Fraud Investigation Office under section 211.
- It is pertinent to note that, good corporate governance involves a commitment of a company to run its business in a legal, ethical and transparent manner- a dedication that must come from the very top and permeate throughout the organisation. Company secretary is a vital link between the top and rest of the organisation. The Act introduces a self regulated corporate governance regime thereby enhancing the reliance on their Company Secretaries. The changes promulgated in the Act would go a long way in establishing considerable authority of the CS over matters relating to the internal regulation of the company.

Role of Company Secretary in Banking Industry

In any country, banking industry plays a key role in the economic development by providing necessary impetus to each and every sector, which contributes to Proper governance of the affairs of any organization, particularly in the banking sector is of paramount importance. Such organizations, both in the private sector or public sector, be it a statutory body under any specific legislation or under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 and 1980 or under the Companies Act, 1956, are to be managed properly by the Board of Directors by adhering to the prescribed rules, regulations, prudent systems & procedures and carrying out business dealings in a transparent manner.

The role of the Company Secretary in different management hierarchy, varies from the positions held in the organization and the functions looked after by him/her. Company Secretary’s functions encompass a wide spectrum of duties and responsibilities, which, if laid down, would be a never ending list. However, for the sake of brevity and to be precise, some of the important tasks, generally entrusted to a Company Secretary and satisfactorily discharged by him/her in the banking organizations, are enumerated below.

Adherence to Regulatory Guidelines

Company Secretaries in the Banking Companies formed either under the Companies Act 1956 or any other legislation(s) and having Banking Licence from RBI under the Banking Regulation Act 1949, have to discharge onerous responsibility not only to ensure compliance

with the various statutory provisions as a Principal Officer, but also to ensure fulfilment of the requirements of various allied Statutes, Rules, Regulations issued by statutory authorities/ Govt. agencies including RBI, SEBI, Ministry of Finance/Ministry of Company Affairs, Govt. of India on issues related to the banking sector.

Company Secretaries are in a better position to discharge this responsibility with greater confidence. Company Secretaries also play an important role in the process of conforming to the different statutory/regulatory requirements as prescribed by RBI such as maintaining Statutory Liquidity Ratio, Cash Reserve Ratio, Capital Adequacy etc. Banks are also required to ensure compliance with the lending norms in different sectors/categories as specified by RBI from time to time. In view of strict banking governance norms, especially to achieve Basel I/II compliance targets, professional services rendered by Company Secretaries, in this regard, deserve due recognition.

Formulation of Corporate Management Policies

Company Secretaries generally take part in the formulation of various corporate policies for approval by the Board of Directors. Threadbare discussions are held by the Corporate Management Team including the Company Secretary, before any policy is firmed up. His/her views on any corporate matters are held in high esteem in the banking sector, in view of diverse knowledge/expertise acquired as a qualified Company Secretary.

Conducting Corporate Meetings

Smooth and systematic conduct of Board/Directors' Committees/shareholders' meetings in conformity with the provisions of the Companies Act, Banking Regulations Act etc. and to comply with all related statutory functions are the inherent functions performed by the Company Secretary. His administrative acumen is reflected in the manner in which all such Corporate Meetings are conducted right from convening such Meetings till their completion.

Active Contributory to Corporate Governance

Company Secretary in Practice generally involves himself/herself in the establishment of various corporate governance practices in the organization. In the banking sector also, such role is played by the Company Secretary, who acts as Secretary to the different Directors' Committees constituted to look after various matters for better management practices. Some of the Committees of Directors in banking organization, where he/she acts as Secretary, are

–

- Audit Committee of the Board
- Shareholders'/Investors'/Customers' Grievance Redressal Committee
- Remuneration Committee.
- Shares/Securities Transfer Committee
- Management Committee
- Risk Management Committee
- Fraud Monitoring Committee

Liaison in the Audit Process

Company Secretary also keeps a close liaison with the different departments in the organization to enable the Statutory Auditors to complete the audit process in time, till the Accounts are considered/recommended/approved by the Audit Committee/Board and finally adopted by the shareholders at the Annual General Meeting. He/she also ensures compliance with statutory/regulatory requirements including reporting to the Stock Exchanges (in case of listed banking organization), finalization and submission of quarterly/half-yearly accounts, which are subjected to review by Statutory Auditors.

Advice to the Board of Directors

To render proper and timely advice to the Board of Directors and other top executives in adhering to the various prudent corporate governance practices, not only as a pre-requisite for the Listing Agreement but also as a systematic development of core ethical standards is within the domain of the Company Secretary's functions. Being assigned with the task of Secretary to the various Directors' Committees in the banking organization, he/she ensures compliance with the various statutory obligations/requirements, which include formulation of Code of Conduct for the Directors and Senior Management Personnel, adherence to the proper internal control systems, etc. In the matter of servicing shareholders' for payment of dividend (including interim dividend), redemption of preference shares, wherever applicable, further issue of shares etc. Company Secretary's advice is generally sought by the Board of Directors/top management to ensure that the relevant laws, rules, regulations, guidelines, if any, are complied with.

Risk Management Functions

In view of the complex nature of the guidelines issued by RBI from time to time in the matter of assessment of various risks involved such as credit risk, interest risk, market risk etc., the professional knowledge of the Company Secretary facilitates evolving appropriate strategy in such matters without jeopardizing the interest of the Banks. Different criteria/systems are developed by the individual banks to assess the nature of risks involved in the bank's dealings on credit management, investment/disinvestment strategy, determining bank's prime lending rates etc. Now-a-days the professional knowledge of the Company Secretaries is also utilized by the Banks in various decision making process.

Formulation of Recovery Policy Another important area where Company Secretary generally renders effective and fruitful services, is to participate in the formulation of appropriate recovery policy for approval by the Board. The functions of Banks including Non-Banking Finance Companies and Development Finance Institutions include lending activities to various sectors/industries and categories of customers, such as individuals, firms, corporate bodies etc. Hence, their recovery policy varies depending upon the category of loan/investment portfolio and quantum of assistance at stake. As is common in banking parlance, Standard/Performing Assets and Stressed/Non-performing Assets (NPAs) are to be dealt with based on separate strategies/principles and degree of importance. Such strategy differs from Standard to NPAs. Attention/focus on recovery from Standard Assets is generally drawn/thrust not only to ensure maintenance of quality of assets, but also to arrest slippage of Standard Assets to NPA category. On the other hand, intensive endeavour is made by bank management to initiate appropriate timely recovery steps depending upon the nature of NPA such as

substandard, doubtful and loss assets, classified as per the guidelines issued by Reserve Bank of India from time to time.

Recovery policy of the banks also envisages, inter-alia, One Time Settlement for recovery of dues from NPAs through protracted negotiations in the recovery settlements by applying prudent negotiating skills to realize best possible deal for the organization. Company Secretary, when assigned with such tasks of recovery process, along with other assignments, offers suggestions in consultation with the legal executives in the banks for timely action for recovery under the Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002, which has proved to be an effective tool for the bank management to realize dues from Non-performing Assets with greater promptness.

Merger/Acquisition Process

Company Secretary also plays an important role in the process of merger and amalgamation in the Banking sector and/or for any takeover, acquisition of any target/weak bank either as a strategic decision to bail out any weak bank, as may be advised/permitted by Reserve Bank of India, or as a policy decision to expand the bank's business domain. Armed with adequate professional knowledge/expertise in this field, the role played by the Company Secretary in such tasks, to ensure compliance with the various statutory requirements under the Companies Act, Banking Regulations Act and other allied legislations/Regulations, is quite significant.

In the prevailing global economic scenario, the issues arising out of overseas acquisition/take over etc. in the banking sector, can be effectively dealt with by the Company Secretary. His/her professional skills with legal background and far sightedness in dealing with such matters, helps the top management not only to ensure compliance with different regulatory requirements in the countries involved, but also to strike a better deal for the organization for takeover/merger of any banking company.

Resource Mobilization

Strategy For mobilization of resources by way of shares/Bonds etc., the role played by Company Secretary is of paramount importance. Right from deciding on the nature of resources such as Share Capital, Subordinate Capital/Bonds etc. as per Reserve Bank of India norms upto the actual raising of such capital and during the course of servicing thereof, professional services rendered by the Company Secretary is crucial and widely appreciated/relied upon by the top management.

Compliance Officer

The Company Secretary in the Banking organization, also acts as a Compliance Officer under the Listing Agreement, where the shares/securities of the Banking organization are listed with any Stock Exchange. He/she also advises on various compliance requirements, applicable to the concerned Banking organization and periodically certifies to the appropriate authority(ies).

Conclusion

In the light of latest overwhelming transformation of Indian economy at the global platform, Indian government is stepping forward with the agenda of "A resilient, sustainable economy that optimises quality of life for all along with inclusive economic growth at global platform"

The disclosures, transparency, accountability and investor protection are the back bone of the orderly development and growth of the capital markets.

Company Secretary as a compliance officer and as a facilitator of legal compliance in the corporate has developed themselves as professional having core competence in compliances and corporate governance, compliance management and sustainable growth of capital market.

They are now popularly known as governance professionals in capital markets and are more frequently called upon to guide the Corporate Board on various strategic, governance and compliance issues related to capital markets.

This makes the role of a company secretary more crucial and decisive in ensuring the required compliances as per the market needs and to take the financial sector forward towards the inclusive growth of the nation at par.

Initial Public Offering (IPO): A New Trend

CS Anurag Gupta*

Introduction

After 70 years of Independence from British Colonialization, India has come down a long way in the process of rebuilding its economy. Trade liberalization, financial liberalization, Government reforms were some of the important steps which helped economy to gain momentum. The economy of India has been emerged as the fastest growing major economy in the world as per the International Monetary Fund (IMF). The Government of India had also forecasted a growth rate of 7.1 per cent during the F.Y. 2016-17. This acceleration in the growth rate was a result of the combined impact of strong government policies along with Reserve Bank of India's (RBI) focus on inflation supported by global commodity prices. As per the IMF World Economic Outlook Update (Jan 2017), India's economy is expected to further accelerate to 7.7 per cent during F.Y. 2017-18. India has retained its position as the third largest startup base in the world with over 4,750 technology startups, with about 1,400 new start-ups being founded in 2016, according to a report by NASSCOM. India's foreign exchange reserves stood at USD 366.781 billion as on March 17, 2017 as compared to USD 360 billion by the end of March 2016, according to the data from RBI. The Indian retail investors generally believe that the Indian stock markets follow unpredictable patterns governed primarily by investor psychology and market manipulations and are therefore unpredictable. This age old belief has its foundations in the pre-reform stock market trends. However, reforms have changed all that. Today, the stock markets closely follow economic trends and are aligned to the global economic and financial market performances. Since the stock markets move in anticipation of future events, market movements actually precede the economy movements. As such therefore, shifts in market trends are seen ahead of major shifts in economic trends. The Indian economic scenario witnessed a transformation from 1991 through economic liberalization, the like of which we witness today. However, this phase ended in 1994. Movements in the stock market can have a profound economic impact on the economy and everyday people. A collapse in share prices has the potential to cause widespread economic disruption. Often share price movements are reflections of what is happening in the economy. E.g. a fear of a recession and global slowdown could cause share prices to fall. The stock market itself can affect consumer confidence. Bad headlines of falling share prices are another factor which discourages people from spending. On its own it may not have

* Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

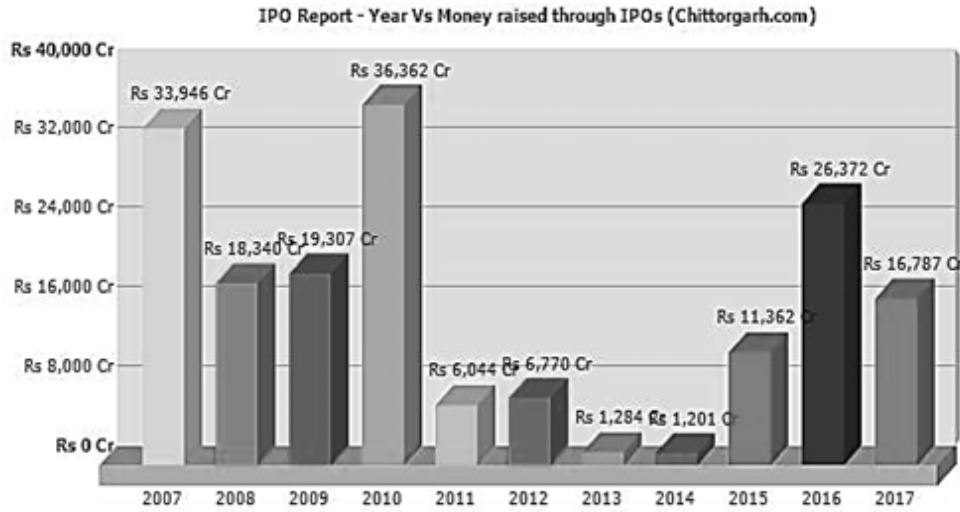
much effect, but combined with falling house prices, share prices can be a discouraging factor. However, there are times when the stock market can appear out of step with the rest of the economy. In the depth of a recession, share prices may rise as investors look forward to a recovery two years in the future. The role of stock markets as a source of economic growth has been widely debated. It is well recognized that stock markets influence economic activity through the creation of liquidity. Liquid financial market was an important enabling factor behind most of the early innovations that characterized the early phases of the Industrial Revolution. Recent advances in this area reveal that stock markets remain an important conduit for enhancing development. Many profitable investments necessitate a long-term commitment of capital, but investors might be reluctant to relinquish control of their savings for long periods. Liquid equity markets make investments less risky and more attractive. At the same time, companies enjoy permanent access to capital raised through equity issues. By facilitating longer-term and more profitable investments, liquid markets improve the allocation of capital and enhance the prospects for long-term economic growth. Furthermore, by making investments relatively less risky, stock market liquidity can also lead to more savings and investments.

Going Public or Initial Public Offering (IPO) is now one of the main tool for a business to raise capital in hope of expanding, writing off debts; Venture Capitalists may use IPO's as an exit strategy- a way of getting out of their investment in a company. The financial benefit in the form of raising capital is the most distinct advantage for a company coming out with its IPO. The capital can be used to fund research & development, fund capital expenditure. Another advantage is an increased public awareness of the company because IPOs often generate publicity by making their products known to a new group of potential investors; subsequently this may lead to an increase market share for a company. The first goal of an IPO is to sell the pre-determined number of shares being issued to the public at the best possible price. This means that very few IPOs come to market when the appetite for stocks is low - that is, when stocks are cheap. When equities are undervalued, the likelihood of an IPO getting priced at the high end of the range is very thin. Valuing an IPO is no different than valuing an existing public company. Consider the cash flows, balance sheet and profitability of the business in relation to the price paid for the company. Sure, future growth is an important component of value creation, but overpaying for that growth is an easy way to lose money in investing. Some of the factors that play a large role in an IPO valuation are not based on numbers or financial projections. Qualitative elements that make up a company's story can be as powerful - or even more powerful - as the revenue projections and financials. A company may have a new product or service that will change the way we do things, or it may be on the cutting edge of a whole new business model. Another aspect of IPO valuation is industry comparable. If the IPO organization is in a field that already has comparable publicly traded companies, the IPO valuation may be linked to the valuation multiples being assigned to competitors. The rationale is that investors will be willing to pay a similar amount for a new company in the industry as they are currently paying for existing companies. In addition to viewing comparable, an IPO valuation depends heavily on the company's future growth projections. Growth is a significant part of value creation and the primary motive behind an IPO is to raise more capital to fund further growth. The successful sale of an IPO often depends on the company's plans and projections for aggressive future growth.

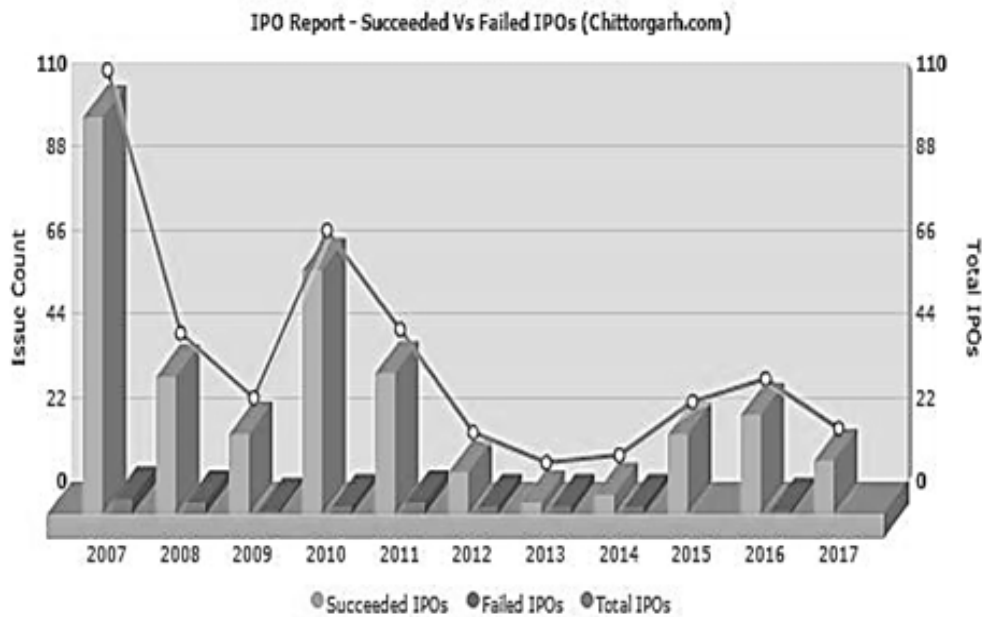


Source: Primedatabase.com

The fact that almost 90 per cent of the companies are backed by private equity attributes the quality and the rush of IPO. It shows that an outside investor has validated the company which is a comforting factor for retail public investors. With companies backed by private equity investors, there is comfort among retail investors that the company and its promoters have had a history of dealing with outside capital and that corporate governance, the board and the overall corporate culture is more robust. Such factors make a private equity-backed company more attractive for investors. Given the fact that private equity investors have limited investment periods, the opening up of the primary markets in the last two years has resulted in several of them bringing their portfolio companies to the market. There are companies coming from sectors that are not necessarily from among the major sectors of the market. In the last two years, the IPO market has given investors the opportunity to invest in companies such as India's largest coffee chain Coffee Day Enterprises Ltd, fruit beverage maker Manpasand Beverage Ltd, diagnostics chains Dr Lal Pathlabs Ltd and Thyrocare Technologies Ltd, staffing and business services firms such as TeamLease Services Ltd and Qness Corp. Ltd. and small finance banks such as Equitas Holdings Ltd and Ujjivan Financial Services Ltd as well as entertainment park Adlabs Entertainment Ltd, among several other under-represented or entirely new growth stories. This contrasts to the IPO phase of early 2000s when technology or software service companies were the rage in the bull run leading up to the global financial meltdown in 2008, which was dominated by capital intensive industries such as infrastructure, power and real estate. It is not just the sectors from which these companies are coming from that differentiate the current IPO run. Even the reason why these companies are approaching the market is significantly different from the earlier periods. Companies are not just seeking to raise large sums of money for capital expenditure but are raising money to provide an exit opportunity to existing private investors.



Source: Chittorgarh.com



Source: Chittorgarh.com

The Dutch East India Company became the first public company in the world to issue its stock through IPO in the year 1606. The company was established in 1602 when the Dutch Government granted it a 21-year monopoly in the Dutch spice trade with the East Indies and sovereign rights in any newly discovered territories. The company started paying dividend from 1610 onwards partly in money and spices. The Dutch East India Company impacted on

European life, changing its food (adding spice). It also stimulated the development of scholarly interest in the languages, cultures and religions of the territories it acquired within the Dutch academy, to a degree almost unrivaled elsewhere in Europe. In 1796, they began to collect debt and the Dutch government, who had been backing them before, could not pay it off. They finally went bankrupt in 1800, and the Dutch government collected all of the excess debt they left behind.

Alibaba Group Holding Ltd. brought the record breaking IPO valued at \$25 billion in the year 2014 by issuing about 48 million additional shares, pushing up the offering value of the Chinese Internet giant. Alibaba priced its IPO at \$68 share initially to become the biggest US offering ever. Its shares then opened over 36 per cent higher than the offering price at \$92.70 and finished out the first day of trading at \$93.89. After its first day of trading, Alibaba's market value was \$231.4 billion, larger than other industry standard bearers like Amazon, Facebook and Twitter.

However, now the markets are waiting what is expected to be the biggest public offering in history. The giant going public is Saudi Aramco, the national company of Saudi Arabia. It is expected to have a \$2 trillion value, more valuable than Apple or Alibaba. The Saudis plan to offer up to 5 per cent of Aramco in the IPO, at a predicted price of \$100 billion. This would give Aramco a valuation of \$2 trillion, making it the largest IPO ever. Initially, the IPO was expected to take place in early 2018, but the expected date has since been pushed off to late 2018 or early 2019. This is likely due to Aramco's desire to complete the financial restructuring process to make the company more attractive to investors.

Established in 1875, Asia's oldest and world's 10th largest stock exchange by market capitalization, BSE Ltd. created history when its shares got listed at a 34.62 per cent premium on rival NSE. Before BSE, MCX was the first commodity exchange to list on stock exchange in India in the year 2012. BSE was cross listed as SEBI's rules do not allow self-listing for an exchange. BSE derives revenue from a variety of sources including revenue from trading activities on the exchange, such as trading fees and trading tariffs, revenue from post-trade services, such as clearing, settlement, depository, custody and nominee service fees, and initial and recurring listing fees from equity, debt and derivative products, and subscription fees from data products. Hence, it had strong brand recognition with a proven track record of innovation.

Another bumper listing of supermarket chain D-mart's parent Avenue Supermart Ltd. created record while opening at 102 per cent premium on the listing day giving investors more than 100 per cent profit. The stock initially closed at Rs. 640.75, up 114 per cent on BSE. The company has reported a CAGR of 40.4 per cent in its revenue in its last five years. D-mart endeavor to minimize its operating costs in several ways such as owning underlying real estate or entering into long-term lease arrangements for a majority of D-mart stores in order to minimize rental costs, procuring goods directly from vendors and manufacturers, employing an efficient logistics and distribution system and maintaining a strong focus on product assortment to minimize inventory build-up, supported by efficient store operations.



Source: Global Report on IPO-EY

The prospects of global IPO activity looks more positive at the start of 2017 compared with 2016 as many threats to the stability of global economy is at ease and investors are regaining confidence. Despite the increasing availability of private capital, appetite for public listings is strong, among both companies and investors alike. Doing proper research before the actual investment is extremely important for the investors. Gaining knowledge about the company coming out with an IPO is necessary to be able to take decisions and minimize risk of loss in short as well as in long run. Before making an investment, it is essential to look into the background of the company and the possibility that the stock provides good returns. There are various available resources to get knowledge about the IPOs that are going to come in the Indian stock market. It is preferable to choose IPOs of the company from different sectors of the economy giving small actual gain rather than big potential gain. Since capitalism has existed, investing in public companies has been an engine of capitalism that lets individuals invests in large firms that have created vast wealth for shareholders. The process is complex, and investors need to be aware of IPO timing, but understanding the road to creating an IPO can be lucrative for companies, underwriters and investors alike.

List of upcoming IPO in 2017

(Source: Moneycontrol.com)

Eris Lifescience	CDSL	Vodafone India
GTPL Hathway	Au Financiers	Go Airlines
Prataap Snacks	Continental Warehousing	Security & Intelligence Services
NSE India	GVR Infra Projects Ltd.	GR Infra projects
Paranjape Schemes Ltd.	SSIPL Retail Ltd.	SBI Life Insurance
Matrimony.com	Sandhar Technology Ltd.	Aster DM Healthcare
Maini Precision products Ltd.	KPR Agrochem Ltd.	Genesis Colors
New Delhi Center for Sight	Nihilent Technologies Ltd.	Central Bank Home Finance
Hinduja Leyland Finance Ltd.	Seaways Shipping & Logistics Ltd.	VLCC Health Care
Mas Financial System	SIS Ltd.	Ratnakar Bank

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SME - As Emerging Capital Market Place

CS Meenu Gupta*

Introduction

An effective and crucial role is played by capital market in economic development of a nation. It provides the financial resources needed for long-term and sustainable development of different sectors of economy. The zone of activities in capital market is dependent partly on savings and investment in the economy and partly on performance of industry and economics in general. It is held that in pre-seventies, the rich is only investing in market whereas the other Indian investor parked their savings in bank accounts and Unit Trust of India.

Corporate sector seek loan funds from the government owned financial and investment institutions for their expansion and growth or relied on their own retained earnings in and before sixties and seventies when capital market were quite inactive. The early independent era have seen the capital market as passive players in economic development perspective and was unable to mobilize the financial resources of nation in required volume. Investing in stock market appear as a capital marketplace in late 1970s when investors thought of investing in the same.

Ever since the liberalization of Indian Economy in early 90's, there has been a commendable growth of Indian capital markets with close to 5,000 Initial Public Offerings (IPOs), next only to that of United States. Though India remained low in terms of capital raised during the period compared to that of Developed Countries and other BRICS nations, Indian Companies were still able to bring capital from across the world.

The capital market includes the stock market (equity securities) and the bond market (debt). A capital market is a market for securities (debt or equity), where business enterprises (companies) and governments can raise long-term funds. It is a market where funds are lent for periods longer than a year, as the raising of short-term funds takes place on money markets.

The Indian Securities market consists of primary as well as secondary (stock) market in both equity and debt wherein primary market provides the channel for sale of new securities, and the secondary market deals in trading of securities previously issued. The issuers of security issue (create and sell) new securities in primary market to raise funds for investment either through public issues or private placement. There are two major types of issuers who

* ACS, MBA(F). The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

issue securities. The first being the corporate entities who issue mainly debt and equity instruments (shares, debentures, etc), while the governments (central and states) issue debt securities (dated securities, treasury bills, etc). The secondary markets enable participants who holds securities to adjust their holdings in response to change in their assessment of risk and return. A variant of security market is forward market, where securities are traded for future delivery and payment in the form of futures and options. The futures and options can be on individual stocks or basket of stocks like index. Two exchanges, namely National Stock Exchange (NSE) and the Bombay Stock Exchange, Mumbai (BSE) provide trading of derivatives in single stock futures, index futures, single stock options and index options. Derivatives trading commenced in India in June 2000. However, Small and Medium Enterprises (SMEs) herein have emerged as an important alternate capital marketplace for investors in recent years.

Concept of SMEs

Small and Medium Enterprises (SMEs) have a major role in contributing towards long-term economic growth and employment. They act as key factors in economic growth and transformation, creating positive value for the economy and contributing towards sustainable and balanced economic growth, employment and social stability.

The term 'MSME' has been increasingly used to meant small businesses in private sector. Regulators, financial institutions and other stakeholders across the world has been describing small businesses on the basis of their employee strength, annual sales, value of fixed assets, and loan size proxies to define the sector in the context of literature. According to World Bank definition, a Business is classified as MSME when it meets two of the three criteria among employee strength, size of assets, or annual sales.

From business standpoint, MSME has been classified into Manufacturing and service category. MSMEs are defined as those enterprises engaged in manufacturing or producing and providing or rendering services, but based on the investment in Plant and machinery, equipment are as under.

<i>Enterprises</i>	<i>Manufacturing</i>	<i>Service</i>
Micro Enterprises	Upto 25 lakhs	Upto 10 lakhs
Small Enterprises	> 25 lakhs to 500 lakhs	> 10 lakhs to 200 lakhs
Medium Enterprises	> 500 lakhs to 1000 lakhs	> 200 lakhs to 500 lakhs

Growth of SMEs in India

SMEs have made their presence felt in almost all economies of world. They account for nine out of ten businesses globally and provide more than 60% of overall employment worldwide and roughly 80% of jobs in developed world. They contribute approximately 50% of global Gross Value Added (GVA), and an even larger percentage in developed countries.

SME is the second largest workforce in the country after agricultural sector which employed around 60 million people and contributed around 17% to Country's GDP in FY'11. During FY 2012-13, the estimated contribution of Micro, Small and Medium Enterprises (MSME)

sector, including service segment, to the country's GDP was 37.54%; while the total employment in the sector is 805.24 lakh and its share in total export for the year 2014-15 was 44.70%. Further, there has been a growth rate of 36.69%, 37.97% and 37.54% during the period 2010-11, 2011-12 and 2012-13 respectively including service sector in Country's GDP through the contribution of MSME sector, as per the Central Statistical Office (CSO), Ministry of Statistics and Programme Implementation.

MSMEs are accounting for 46 % of industrial production and 95% of total industrial units; they are the largest employment providers with over 6 crores of the Indian population depending on them for livelihood.

MSME sector has progressed in scale and in the scope of business activities over the years, from being referred to just as the Small Scale Industries (SSI) sector in 60s and 70s. Presently, MSMEs have presence across all manufacturing, trade and services sectors in India constituting a formidable component of the country's outstanding economic growth. While MSME have proved themselves since time in delivering quality products and services with the availability of limited resources, they have also made their presence felt across India's key sectors as well as in prominent export markets. MSMEs have made an impact on a range of issues, from industrial progress to entrepreneurship and from job creation to economic empowerment.

The inclusiveness of the sector is highlighted by the fact that around 50% of MSMEs in India are owned by underprivileged groups. Due to its low capital structure, coupled with high labour absorbing power, the sector has played a noteworthy role in achieving rural industrialisation as well. It remained a key driving force for India's complete transition from an agrarian economy to an industrialised one and subsequently, they have been awarded a host of incentives by governments across India. A number of other organisations in the private and non-profit domain have also been aiding MSMEs to remain competitive in a more globalised economic order. This is set to continue in the coming decade as well, with MSMEs requiring access to credit, technological know-how and training centres for bridging the skill gap.

Sources of Finance for SMEs

Financial market acts as a capital provider for SME financing for varied types of firms. Venture Capital, equity/corporate bond issues, hire-purchase arrangements, private equity, leasing, bank loans and overdraft and asset-based financing are supplied as Capital through the business finance market.

SME in India, as per IFC Report, demonstrates \$2.93 trillion gap in SME financing in 2016. There are around 50 million SMEs in India, exercising frugal management skills and using local resources to produce innovative products and services which cater to India's growing needs. These SMEs experience lack of supply for finance, mainly debt, to develop and finance their growth. Generally, traditional-collateral based lending has been preferred by most lenders. Formal financial sector consisting of Scheduled Commercial Banks, Non-Banking Finance Companies (NBFCs) and smaller banks such as Regional Rural Banks (RRBs) and Urban Cooperative Bank (UCBs) serve not even one-third of total SME debt financing in present emerging economy and the remaining three-fourth prefer either self-financing or raise funds from informal sources including family, friends and family business as sources of

non-institutional finance while money lending and chit funds as institutional sources of finance. Majority of SMEs depend only on credits from bank and bank loans and unorganized sectors to run their business, which have huge rate of interest.

Traditionally, private funds from friends and family form the single largest source of finance to SMEs in India and apart from traditional funding, collateral based lending offered by traditional banks and finance companies is usually made up of a combination of asset-based finance, contribution based finance, and factoring based finance, using reliable debtors or contracts.

Major Hurdles for Raising finance by SMEs

Though there has been a tremendous growth of MSME sector in recent years, smooth access to capital and loans acts to be the important drivers for their growth as most MSMEs face hurdles in ensuring smooth operations of their business with inadequate capital. From inefficacy of measures in credit flows (such as credit scoring for SMEs) to information asymmetry faced by banks and financial institutions, there are plentiful challenges that have impacted the contribution and performance of small and medium enterprises in Indian economy. More than 80% MSME entrepreneurs have to resort to alternate avenues of financing, such as peer-to-peer lending, to obtain credit assistance.

Easy access to finance for SMEs poses significant hurdles:

1. Cost of funds and cost of raising funds and cost of debt are significant.
2. Raising capital through debt, on which SMEs heavily depend on, consist of high risk than with raising finance with equity.
3. Due to limited finance, SMEs invest less in latest technology, infrastructure & R & D.
4. SMEs face problems related to inventory management and recovery from customers affecting working capital funding and management;
5. SMEs are severely affected by inflation, depreciation of currency and global recession.
6. Delay in decision to lend credit financing to SMEs and disbursing loan.

The bank financing is limited due to various reasons such as SMEs are treated as high risk borrowers; there is a difficulty in assessing credit worthiness of SMEs due to lack of information (information asymmetry); high administrative and lending cost to lend relatively smaller amounts to SMEs; lesser security against debt, losses in initial years and negative cash flows and this limitation of bank funding affects business of SMEs, their profitability and long term survival and growth.

Start-ups facing hurdles in getting finance from conventional banks, wherein only retained earnings and borrowing from friends and family form a major source of initial business capital. Further, the advancement of information communication technologies has made angel investment networks an innovative method of raising capital. However, IT based businesses seem to have captured the attention of such investors.

Govt. Initiatives to help ease in raising capital by SMEs

Lack of skilled manpower, high import costs, limited capital, little R&D costs, have remained as challenges in low contribution of MSMEs to Gross Industrial Production. Recent initiatives by Government of India have been undertaken towards encouraging entrepreneurs and empowering MSMEs to overcome funding obstacles.

Reduction in Tax Rates

An announcement for reduction in corporate taxes has been made in Budget 2017 from 30% to 25% for SMEs with an annual turnover of less than Rs. 50 crores. Further, the presumptive tax rate for SMEs with an annual turnover of up to Rs. 2 crores has been lowered from 8% to 6%. Since these enterprises work on low profits, and their survival is often threatened by even minor fluctuations in business, the measures above would increase the bottom-line of SMEs. The enhanced financial viability would increase the survival rate of SMEs.

Additionally, the proposed reduction in presumptive tax is applicable only for a firm's gross receipts that are received via digital transactions. Also, no cash transaction above Rs. 3 lakhs would be permitted going forward. Both these measures have been designed to increase transparency and widen the tax base through digitalization.

Facilitating finance and funding

To ensure more credit availability to small businesses to finance their working capital requirements, the lending target has been doubled from Rs. 2.44 lakh crores for next fiscal year. On December 31, 2016, an increase in government credit guarantees for SMEs from Rs. 1 crore to Rs. 2 crores has already been announced.

Since, most traditional banks are unwilling to give loans to SMEs due to the fear of defaults, tax concession on provisions for non-performing assets (NPAs) and capital infusion of Rs. 10,000 crores for state-owned lenders would make loans more accessible to SMEs.

To encourage more investments into start-ups, the condition of continuous holding of 51% voting rights has been relaxed for carrying forward of losses by start-ups, provided the founder remains invested in business.

Ensuring financial transparency through 'Digital India'

The app, Aadhaar Pay, the merchant version of Aadhaar Enabled Payment System (AEPS), launched would enable consumers to make payments without using cards, e-wallets or even mobile phones, since the merchant's device would be linked to an Aadhaar biometric reader. It would be a boon for raising loans, enabling fintech lenders to link repayment to payments received by SME.

The government would be targeting Rs. 2500 crore digital transactions in FY18 through BHIM, Aadhaar Pay, IMPS and debit cards. The Finance Minister indicated that banks would have to introduce 10 lakh new point-of-sale (PoS) terminals by March and 20 lakh Aadhaar based PoS terminals by September, allowing more digital transactions, which would enhance financial inclusion and transparency.

Tax Transparency through GST

The implementation of GST will help solve long existing challenges prevalent in the current taxation system. For SMEs, GST will help eradicate indirect taxes, have more transparency of tax process, draw projections of production cost and gain easy access to new geographies for business expansion.

Raising Funds by SMEs through Capital Market

SMEs businesses, though play a critical role in global economic development and are engines of innovation and job creation, yet they face hurdles to obtain financing. Characterised by their small size, they have relied on bank lending. However, following the global financial crisis, this source of financing has become increasingly difficult to access and threatened to suppress the growth of SMEs and economic development. SMEs can bypass traditional bank lending by issuing equity and debt securities in capital markets.

SME-focused equity platforms have been established across the globe, offering an alternative to main listing boards on national stock exchanges. Equity platforms provide SMEs with the opportunity to IPO once they have become well-established. In most markets, the SME platform acts as a second-tier listing alternative to the main stock exchange. Such platforms are characterized by lower listing requirements and costs to list than the mainboard, helping to make it a viable solution for SMEs seeking finance. SME equity platforms are best suited to the largest SMEs (i.e. the medium segment) given the initial cost and ongoing listing requirements most platforms demand.

The strengthening of prudent regulation in banking sector has the effect of reducing intermediation capacity of banking system as banks become more risk averse when extending loans especially to SME sector. Therefore, it has become crucial to examine possible alternative financing channels for SMEs. Raising funds by way of an organized, transparent, orderly functioning and reliable capital market could provide an important alternative source of finance for SMEs. In addition, emergence of alternative markets where, on one hand, SMEs can raise funds and on the other, investors have access to a wider array of investment opportunities are important to foster the development of capital markets.

However, Capital markets are the obvious alternative to bank lending. Despite the challenges faced by the current platforms, vibrant SME capital markets promise benefits for many stakeholders. Issuing equity and debt securities can provide SMEs with the stable, long-term financing that bank lending typically does not. Because these securities are tradable, their prices provide information about the performance and value of SMEs concerned. This transparency, combined with the ease of exit created by tradable equity and debt, makes SMEs more attractive investments for venture capitalists (VCs). And it creates a discipline on SMEs' management, improving their internal governance and external communications.

SME securities give investors access to a broader and more diverse set of investment opportunities within a regulated and transparent environment. And exchanges earn new revenue streams by intermediating SMEs and investors, while helping to increase the number of companies that subsequently graduate to their main exchange board. By encouraging more

SMEs to start up and to expand, SME capital markets stimulate economic growth and job creation. Successful SME capital markets can add upto 0.1-0.2% uplift in the contribution of SMEs to overall GDP each year, while supporting the creation of hundreds of thousands of new jobs globally. SME Capital market is a golden opportunity through which progressive business can raise growth of capital and make success stories.

A well-regulated capital market will ensure greater allocation of capital with a risk transfer mechanism while also helping build overall growth and development. The high dependency of SMEs on bank credit, however, while raising capital through equity will reduce reliance of SMEs on debt, and such restructuring will be helpful to SMEs, capital market and the economy at large.

The SMEs having bank loans (classified as standard/sub-standard/doubtful) can also be converted to equity financing through SME listing (subject to listing guidelines). It may reduce non-performing advances of banks. Instead of giving loan to SME, a bank may prefer to invest in its equity shares or proceed with securitization. It may also have positive effect on corporate debt restructuring mechanism for SMEs.

Listing on SME platform will help reduce finance cost, quick and easy access to finance, improving technology access, allowing exit route strategy, tax benefits, and improved rating of credit for SMEs. An SME can invest in another as well for strengthening the business. The platform provides opportunity to SME entrepreneurs to raise equity capital for growth and expansion while at the same time, opportunity for investors to identify and invest in good SMEs at an early stage.

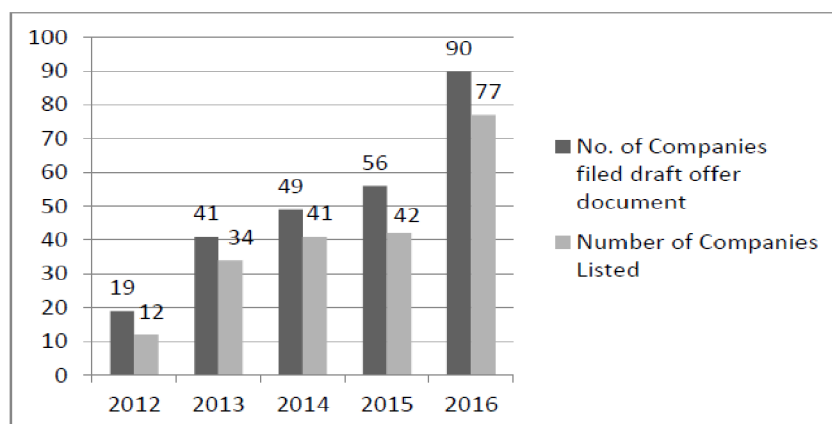
SME Capital Market has peaked Rs. 15000 Crore of market capitalisation. In terms of number of companies and returns they provided, Indian SME Capital Market has become the fastest growing globally.

Table 1 : Growth in SME Capital Market

<i>Parameters</i>	<i>2014</i>	<i>2015</i>	<i>2016</i>
Companies filed offer document	49	56	90
No. of Companies listed	41	43	66
Funds Raised (Rs.in crores)	315	265	540
Companies Migrated	0	12	11

The number of companies listed in 2016 increased to record 66 from 43 companies listed in the previous year. Moreover, the number of companies that filed draft offer document increased from 56 in the calendar year 2015 to 90 in 2016. Meaning thereby, the number of companies filed and getting listed on SME platforms increased substantially.

Figure 1: Growth in Companies filed and listed on SME Platforms



Source: Pantomath Research

SMEs collectively raised Rs. 539.77 Crores during year 2016 as compared to Rs. 265.28 Crores and 315.37 Crores during years 2015 and 2014 respectively, reflecting a significant rise in amount raised through SME Bourses. Average SME IPO size also increased during year 2016 to Rs. 8.18 Crores as compared to Rs. 6.32 Crores and Rs. 7.69 Crores during the previous years 2015 and 2014 respectively. Pantomath Capital Advisors Private Limited lead managed highest number of IPOs representing approximately 30% of the total SME IPOs during 2016. Year 2016 witnessed increased participation from companies belonging to manufacturing sector and service sector. The number of companies engaged in trading and financial services declined due to tightening of eligibility norms by SME Bourses.

Table 2: SME IPOs in 2016

State	No. of Companies	Total Capital raised (Rs. in Crore)
Bihar	2	12
Chandigarh	1	2
Daman & Diu	1	3
Delhi	2	12
Gujarat	25	234
Karnataka	2	14
Madhya Pradesh	3	25
Maharashtra	11	100
New Delhi	3	29
Punjab	1	6
Rajasthan	7	42
Tamil Nadu	2	22
Telangana	1	4
Uttar Pradesh	1	4
West Bengal	4	31

Source: Pantomath Research

State-wise contribution of companies with respective raising of funds is depicted above. Geographically, Gujarat has contributed maximum 25 companies on SME Bourses in the year 2016, followed by Maharashtra and Rajasthan listing 11 and 7 SMEs respectively on SME Bourses. Notably, 11 companies got migrated on to the Main Board, which addressed industry apprehensions on migration ease and manner. This reposes increasing confidence to the SME Capital Market eco-system.

Till Decemeber, 2016 end, 165 companies have been listed on SME Exchange of BSE (of which total 22 companies got migrated to Main Board) and 32 listed on NSE Exchange (of which 1 got migrated to Main Board). These companies represent diverse industry base such as manufacturing, agriculture, aquaculture, food & processing, real estate & infrastructure, media & entertainment, IT & IT-ES, service, finance etc. based out of more than 40 cities.

Many of listed SMEs have preponed their growth cycles and ventured into progressive business plans. Governance Structures, improved credit rating, reduced finance cost, easy finances, branding etc. are some of key benefits besides valuation, which have helped listed SMEs to achieve speedy growth in systematic manner at early stage of their respective business life cycle.

Since its launch, SME Capital Market garnered its first Further Public Offer (FPO) during 2016. MRSS successfully raised Rs.10crores via book-built SME FPO; which was lead managed by Pantomath Capital Advisors Private Limited. Various companies listed on Indian SME bourses has done private placement in the past after their IPO. But this is the first time when a company listed on SME bourses had come up with an FPO. MRSS is a milestone SME company which has recorded a rise of more than 1000% in its stock price over its issue price of Rs. 12.75. The Company is engaged in business of market research.

SMEs which have been listed in 2016 on SME Bourses have rewarded patient and persistent investors with significant returns, appreciating their wealth and building the investors' confidence. SME Stocks that many investors might have ignored considering the risk associated with it, have rallied more than 500 to 800% in the year 2016.

Besides, increasing number of companies is expected to tap SME platforms. Market is also witnessing participation from wider class of investors, which trend is expected to continue. Even institutional investors have started showing interest in SME investing and the market looks up to them with expectation. Most of the listed SMEs have added value to shareholders. More SMEs are expected to take benefits of SME capital markets and in turn benefit their shareholders and other stakeholders.

Impact of raising capital from listed Securities

Raising capital through equity financing will reduce the financial expenses in initial period when the SME is growing and appear as a demanding option due to one time cost of raising funds and no requirement to service debt.

Listing on stock platform not only reduces the cost of credit, but also increases the company visibility and prestige in the market, which enhances their chances further in getting support through improved networking. To achieve this objective the SME platform provides the listing facilities at lower costs and reduced regulations making it easier for the SMEs to list themselves

on the exchange. Envisaging and setting up such a platform was a significant financial innovation in the Indian Markets.

Cost of raising funds and cost of funds are involved in raising equity and is around 7% and 14%. However, Cost of equity is more than cost of debt instruments due to risk and tax factors. Interest cost is 14% of total operating cost of SMEs. As per a report by CRISIL, there is a fall in profits of 14% for SMEs if interest rates rise, i.e. if SMEs borrow from banks, they face various risks related to interest rates related to both for fixed and floating rate of interest. By replacing debt with equity through capital markets, SMEs can avoid or reduce interest rate risks.

Varied investors including venture capitalist, Private equity, High Networth Individuals, retail investors, etc will be interested to invest in SMEs once they are listed. Post listing credibility is established so as to raise funds through other sources apart from equity while also be able to raise foreign sources of funds including Foreign Direct Investment.

Raising capital through debt places interest and loan repayment burden affecting profitability and cash flows whereas no such cash flow commitment is required for equity.

Due to delayed payment from customers, working capital management problems will likely arise, however, SMEs access to capital market will ensure restricting of its working capital requirements. Further, an increase in equity base will ensure greater loss absorption capacity for SMEs. The banks would be more willing to finance if the equity base is increased.

Conclusion

Over the years, there was a need for ensuring easy, quick, and affordable access to SMEs and micro-business for their business growth and development and only through the development of the capital market platform, a significant impact can be seen towards reducing the SME financial gap. Surely, SME Capital Market is an emerging capital marketplace through which progressive businesses can raise funds for growth and expansion.

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Indian Debt Capital Market : Lot more to come

CS Raveena Agrawal*

Introduction

The Debt capital market has gone through significant journey from the traditional lenders on barter exchange basis until the present scenario of rising in bond prices to fell in yields. The situation to be better explained in the words of Sir Robert Kiyosaki:

"It's not how much money you make, but how much money you keep, how hard it works for you, and how many generations you keep it for."

Simply, Debt Capital Market is a combination of:

Debt - a sum of money borrowed from the other party

Capital - introduced for startup of business by owners

Market - medium of sale or purchase

Debt Capital market indicates a place to raise long term funds through G-Sec (Central Government, State Government Securities), Corporate Securities (Financial Institutions, Public Sector Undertakings, Corporate bonds and debentures). The market is also known as fixed income market because of the fixed interest amount. Currently a variety of instruments are offered in the debt market like: MIBOR (Mumbai Inter Bank Offered Rate) bonds, Commercial Papers (CPs), Certificate of Deposits (CDs), Treasury Bills., Medium- to long-term bonds, Call money market, Repo transactions, Collateralized Borrowing and Lending Obligation (CBLO), Other instruments as Debentures, Secured premium notes, Deep Discount Bonds, PSU Bonds / Tax-Free Bonds, Floating Rate Bonds, State Government Securities, STRIPS and Interest Rate Derivative products.

Regulations

The phase of liberalization in 1990 has led to the development of capital market entirely within the purview of the State. The Government issued a notification on March 2, 2000 whereby government securities market is regulated by the Reserve Bank of India while the corporate debt market is regulated by the Securities and Exchange Board of India (SEBI). 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) both exchanges follow the same trading mechanism, trading hours, settlement process, etc. The important

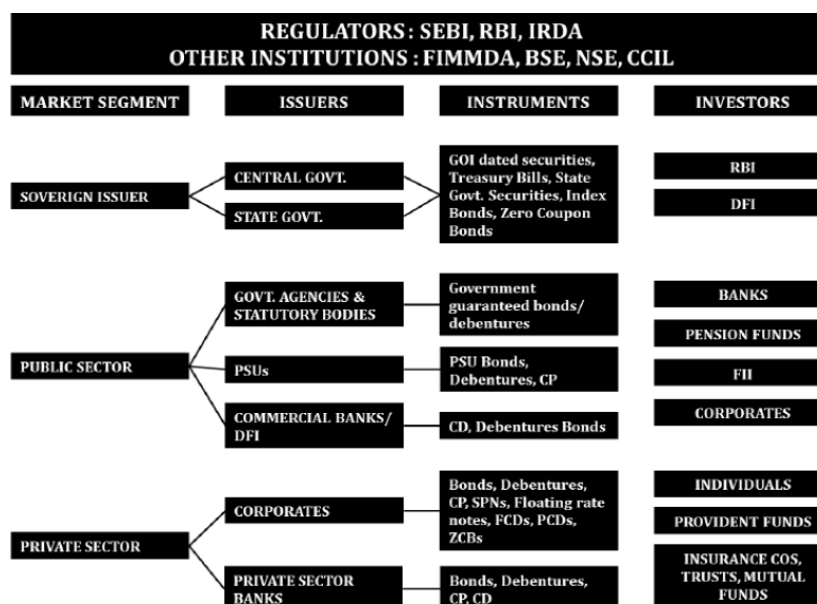
* Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

legislations governing legal framework for the development of capital market in India are: (a) Securities and Exchange Board of India Act, 1992, (b) Securities Contracts (Regulation) Act, 1956, (c) Depositories Act, 1996, (d) Companies Act, 2013.

The key participants in the debt capital market are:

1. Advisor/ Arranger
2. Merchant Bankers
3. Agents
4. Agent Bank
5. Calculation Agent
6. Registrar
7. Custodian
8. Listing Agent
9. Depository Participants (DP): Currently there are two depositories operational in the country as: 1. National Securities Depository Ltd. - NSDL - Having 1.39 crores Demat A/c as on 30-06-2015, 2. Central Depository Service Ltd. - CDSL - Having 9800000 Demat A/c as on 30-06-2015.
10. Credit Rating Agencies: The Indian credit rating industry has evolved over a period of time. Indian credit rating industry mainly comprises of CRISIL, ICRA, CARE, ONICRA, FITCH & SMERA.
11. Legal Advisers/ Company Secretary.
12. Auditors

Chart 1 : Micro Structure of Corporate Debt Market in India



Source: SEBI Working Paper-9 Corporate Debt Market in India, July, 2014

Economic Scenario

India’s general government debt to GDP ratio at 68.5% in 2016 is one of the highest compared to other emerging market economies as South Africa (51.7%), China (46.3%) and Indonesia (27.5%). Of India’s general government debt, the Centre contributed 48 percentage points. “That is why the path of fiscal prudence embarked upon by this government is critical in itself but also as a model for the states” as per Economic Survey of India, 2017.

At 23% in 2015, India had one of the lowest foreign debt-to-GDP ratios among 83 emerging market (EM) countries, although it had risen from 17% in 2005.

BRIC'S BURDEN		
Country	Debt Share* (%)	Ratio[#] (%)
Brazil	8	37.5
Russia	6	39
India	6	23
China	17	13

*Of emerging markets, in \$ terms
[#]Of external debt to GDP Source: Moody's

Source: Moody’s Report 2016

Generally, Government debt as a percent of GDP is used by investors to measure a country ability to make future payments on its debt, thus affecting the country borrowing costs and government bond yields. Comparison for debt to GDP:

<i>Countries</i>	<i>Last</i>	<i>Previous</i>	<i>Highest</i>	<i>Lowest</i>		
Japan	250.40	248	250	50.6	%	Yearly
Italy	132.60	132	133	90.5	%	Yearly
United States	106.10	101	119	31.7	%	Yearly
Spain	99.40	99.8	100	16.6	%	Yearly
France	96.00	95.6	96	20.7	%	Yearly
Canada	92.30	91.6	101	45.3	%	Yearly
United Kingdom	89.30	89	89.3	31.3	%	Yearly
Euro Area	89.20	90.3	92	65	%	Yearly
India	69.50	69.6	84.2	66	%	Yearly
Brazil	69.49	65.45	69.49	5		

Source : Tradingeconomics.com, by country, 1991-2017

Green Bonds Initiative

Green bonds raise funds for projects with environmental benefits, such as renewable energy, low carbon transport or climate adaptation. The largest issuer in 2015 was the EIB, with KfW, EDF, and the Agricultural Bank of China. Following China’s leading \$102.9 billion investment in renewables in 2015, India increased investment by 22 percent to \$10.2 billion.

Data for year 2015:

Country	Amount (USD)	Country	Amount (USD)
USA	10 billion	UK	0.7 billion
Germany	5.6 billion	Denmark	0.6 billion
Netherlands	4.1 billion	Brazil	0.6 billion
India	1.1 billion	Mexico	0.5 billion
China	1 billion	Japan	0.5 billion
Norway	0.9 billion	Hong Kong	0.3 billion

Source: NRDC data, Top countries for Green Bonds in 2015

As per Natural Resource Defense Council latest report green bonds can be key factor to help meet an ambitious target India has of building 175 gigawatt of renewable energy capacity by 2022, which will require a massive estimated funding of \$200 billion.

Accounting Standards

Indian accounting standards are principle based and aligned to international accounting standards. India has so far followed Indian Generally Acceptable Accounting Principle (IGAAP). However, from FY17, it will follow Ind-AS whose principles are closely based on international accounting system called IFRS. This will increase comparability of Indian companies with their international counterparts.

New Accounting Norms		
Under existing standard (IGAAP)	New accounting (Ind-AS)	Impact
Revenues calculated net of excise and duties	Revenues will be calculated by adding excise duty	Higher revenue, lower margin and EPS neutral. Consumer staples, auto, capital goods, and cement companies will be most impacted
Most companies having employee stock option (ESOP) based on intrinsic value	Mandates ESOP cost booked under fair value accounting	Likely to increase employee cost
Proposed dividend is recognised in the same year	Proposed dividend in a year when approved by shareholders	Likey to increase the year end book value of the company. This may lower return on equity (RoE) of high-dividend paying companies
Under M&A assets are recognised at book value	Asset and liability to be recognised at fair value and contingent liabilities to be accounted at fair value. Goodwill value to be tested annually	Companies having high goodwill in balance sheet will see volatilities in their earnings
Current investment valued at cost or market value	Needs to be valued at fair value	Greater volatility in other income, cash-rich companies will be more impacted
Redeemable preference share treated as part of equity	Will be treated as liability, preference dividend will be treated as interest cost	Higher debt to equity and lower EPS
Major repair charged as expenses	Allowed to capitalised	Could lead to lower EPS

Source: CS

Source: Economic Times

<i>IFRS</i>	<i>Ind-AS</i>
	30- Financial Instruments: Recognition and Measurement
7- Financial Instruments: Disclosures	31- Financial Instruments: Presentation 32- Financial Instruments: Disclosures

Ind AS will be mandatory applicable to the following companies:



Source: PWC

The International Accounting Standards Board (IASB) is hopeful that India would in the next five-six years achieve “full convergence” with International Financial Reporting Standards (IFRS).

Listing of Debt Securities

Any issuer desirous of listing can raise funds either as Private placement or Public issue. For listing of debt securities its mandatory to comply with the requirements specified in the SEBI (Issue and Listing of Debt Securities) Regulations, 2008, SEBI (ICDR) Regulations, 2009 and the SEBI (LODR) Regulations, 2015 (Disclosure Regulations).

Process : The process of listing in explained in brief as:

For Public Issue:

Pre Issue Requirements:

- | | |
|--------------------|---|
| General Conditions | <ul style="list-style-type: none"> • Application to recognized Stock Exchange (BSE, NSE) • Obtain in principle approval of recognized Stock Exchange • Obtain credit rating from at least one registered Credit Rating Agency. |
|--------------------|---|

	<ul style="list-style-type: none"> • Enter into an arrangement with a depository registered with the SEBI for dematerialization of the debt securities proposed to be issued. • Appoint one or more merchant bankers registered with the Board at least one of whom shall be a lead merchant banker • Appoint one or more debenture trustees.
Disclosures in offer document:	<ul style="list-style-type: none"> • all material disclosures which are necessary for the subscribers take an informed investment decision • disclosure specified in Schedule I of SEBI (ILDS) Regulations • all other disclosures as per applicable act, rules, regulations, etc
Filing of draft offer document	<ul style="list-style-type: none"> • With designated stock exchange through lead merchant banker, which shall be posted in its website for 7 working days for seeking public comments. • A copy of draft and final offer document shall also be forwarded to SEBI for its records along with due diligence certificate. • Filing with the Registrar of Companies.
Advertisement	To make a advertisement (not to be misleading, manipulative, deceptive, etc.) in an national daily with wide circulation, on or before the issue opening date
	Abridged Prospectus and application forms Electronic Issuances.
Price Discovery	The issue may be at fixed price or the price may be determined through book building process.
	Raising of Minimum Subscription
Post Issue Requirements:	
Trust deed	A trust deed to be executed in favour of the debenture trustee within three months of the closure of the issue
Creation of Security	The issue proceeds shall be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed

Redemption and Roll-over To redeem the debt securities in terms of the offer document, Where the issuer desires to roll-over the debt securities issued by it, a special

Resolution through postal ballot having the consent of not less than 75% of the holders by value is to be passed.

For Private Placement:

Pre Issue Requirements:

General Conditions	<ul style="list-style-type: none"> • To issue such debt securities in compliance with the provisions of the Companies Act, 2013, rules prescribed there under and other applicable laws. • Obtain credit rating from at least one registered Credit Rating Agency. • The debt securities proposed to be listed are in dematerialized form.
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Disclosures as per Regulation 21	<ul style="list-style-type: none"> • Disclosure specified in Schedule I of SEBI (ILDS) Regulations accompanied with the latest Annual Report • The disclosures as provided shall be made on the web sites of stock exchanges where such securities are proposed to be listed.
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Filing of draft offer document	<ul style="list-style-type: none"> • The draft information memorandum is submitted to the stock exchange for "in principle" listing approval. • Once the information memorandum is finalized, it must be uploaded onto the website of the relevant stock exchange.
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- Abridged Prospectus and application forms
- Electronic Issuances.

Raising of Minimum Subscription

Post Issue Requirements:

Filing with the Registrar of Companies.

Trust deed	A trust deed to be executed in favour of the debenture trustee within three months of the closure of the issue
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Creation of Security	The issue proceeds shall be kept in an escrow account until the documents for creation of security as stated in the offer document, are executed
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Stock Exchange Compliances for listing/ listed Companies:

Apart from the above compliance there are certain stock exchange requirements to be eligible for listing:

Minimum eligibility criteria BSE:

<i>Parameters</i>	<i>Small Cap Companies</i>	<i>Large Cap Companies</i>
Min. post issue paid up capital	3 crores	3 crores
Min. Issue size	3 crores	10 crores
Min market capitalization	5 crores	25 crores
Min public shareholders		1000
Min Turnover		3 crores in preceding 3 yrs

Eligibility criteria NSE:

<i>Issuer</i>	<i>Criteria</i>
Corporate	<ul style="list-style-type: none"> • Paid-up capital of Rs.10 crores; or • Market capitalisation of Rs.25 crores (In case of unlisted companies Net worth more than Rs.25 crores) • Credit rating
PSU	<ul style="list-style-type: none"> • Credit rating • Qualifies for listing under the respective Acts, Rules or Regulations
Mutual Funds	Qualifies for listing under the respective Acts, Rules or Regulations
Infrastructure	<ul style="list-style-type: none"> • Credit rating
Companies	<ul style="list-style-type: none"> • Qualifies for listing under the respective Acts, Rules or Regulations
Banks	<ul style="list-style-type: none"> • Scheduled banks • Net worth of Rs.50 crores or above • Qualifies for listing under the respective Acts, Rules or Regulations

Stock Exchange Guidelines to be followed

- (a) Permission to use name of Stock exchange in prospectus
- (b) Submission of letter of application
- (c) Filing prospectus with ROC
- (d) Allotment of Securities within 30 days of the date of closure of the subscription list
In case of Book Building issues, allotment shall be made not later than 15 days from the closure of the issue
- (e) Trading Permission within 7 working days of finalization of the basis of allotment
- (f) Requirement of 1% Security Companies making public/rights issues are required

- to deposit 1% of the issue amount with the Designated Stock Exchange before the issue opens
- (g) Payment of Listing fees
 - (h) Compliance of Listing Agreement
 - (i) Periodical Reporting
 - (j) Disclosure of Material event or information

The Supreme Court held in the matter of the *Raymond Synthetics Ltd. Vs Union of India(1992) CLA99* (SC) that the principal objectives of listing are to provide ready marketability and impart liquidity and free negotiability to stocks and shares. Ensure proper supervision and control of dealings therein; and protect the interest of shareholders and of the general investing public.

Listed vs. Unlisted (Pros and Cons)

Good Things

<i>Listed</i>	<i>Unlisted</i>
<ul style="list-style-type: none"> • I have high lightened public profile. • I have improved standing in market place particularly global business like Dr. Reddy’s Lab. • I can easily claim for financial assistance from lending institutions. 	<ul style="list-style-type: none"> • If the company makes loss, I don’t have to share information in public, just like Kingfisher. • It require less paperwork and time to borrow from bank / friend than via share market (SEBI permission, board of directors etc.)

Bad Things

<i>Listed</i>	<i>Unlisted</i>
<ul style="list-style-type: none"> • I have loss of ownership the Company become public property, liable towards public scrutiny and public accountability. • Incase of default to any investor I would be in notorious limelight like Sahara. • I always have to check news for market price of the Company. • It requires heavy management, administrative cost and time consuming. 	<ul style="list-style-type: none"> • I have stable market price, not having big image. • I am too small to qualify for stock exchange listing.

Why still choose Debt Capital Market

A liquid corporate debt market can play a critical role by supplementing the banking system to meet the requirements of the corporate sector for long-term capital investment and asset creation. The economic advantages of having a viable private DCM can be grouped into three broad categories:

1. Diversification
2. Efficiency in managing cost of capital
3. Financial stability

Constraints in Growth

The debt capital market in India is still underdeveloped due to the structure of the Indian financial system and regulatory structure and lack of policy regimes for evolution in the global market. Currently Banks the lending institutions are exposed to numerous risks as the Bank who introduced the Company to the depositor than any default by the companies like Kingfisher, Sahara, etc. (in repayment) can cause harm to depositor, who otherwise wouldn't have opted to get exposed to this default company.

1. Lack of Risk Management Products: Financial risks associated with financial securities like: a) Credit Risk, b) Interest rate risk, c) Settlement risk d) Liquidity risk. The Indian corporate debt market is also constrained by lack of adequate risk management products, be it credit default swaps (CDS) or interest rate futures (IRF).
2. Multiple and overlapping financial supervisory bodies: The Indian financial regulatory structure is quite complex with a lot of overlapping and ambiguous regulatory jurisdictions. With multiple agencies entrusted with the task of regulation and supervision, the lines of jurisdiction become blurred often leading to inefficiencies in the regulatory process often causing friction.
3. Legal impediments: In India enforcement contract litigation is often embroiled in delays and deficiencies of India's overburdened legal system, several missing and inadequate legal structures not the least of which are prohibitive costs.
4. Lack of remedial opportunities increases the risk of corporate bond lending.
5. Low primary issuance of corporate bonds leading to illiquidity in the secondary market,
6. Narrow investor base,
7. High costs of issuance,
8. Lack of debt market accessibility to small and medium enterprises,
9. Dearth of a well-functioning derivatives market that could have absorbed risks emanating from interest rate fluctuations and default possibilities,
10. Large fiscal deficit
11. High interest rates and the dominance of issuances through private placements and AAA rated bonds which in turn also prevent retail participation and aggravate the dependence on bank financing.

Reforms in Capital Market

The government took several measures to develop capital market in the post-reform period, following which the capital market reached new heights to some extent, it includes:

1. Formation of SEBI for investors protection in 1992
2. Setting up of NSE for trading through out the country.
3. Dematerialization of Securities.
4. Screen Based Trading System
5. Establishment of Investor Education and Protection Fund (IEPF)
6. Clearing Corporation of India introduced for clearing all transactions.
7. Credit rating Agencies
8. Derivative Trading
9. Rolling Settlement
10. Access to Global Market as American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs).
11. Corporate Governance
12. Set up of a National Institute of Securities Markets (NISM) for teaching and training intermediaries
13. Gold Exchange Traded Fund (GETF)

Suggestions for improvement: To make more to come

Focus on eliminating the short-comings and plugging the gaps India's DCM development efforts can concentrate on major areas as:

1. *Technical Reforms* : Technical reforms can be undertaken fairly quickly and easily. Indian authorities have already made some progress in this area, with several additional announcements regarding digitization of Government work.
2. *Political Reforms* : These would be more challenging issues that will rub up against political constraints. Progress in these areas will be slow, with the full slate unlikely to be completed for nearly a decade. Political commitment will be essential, though admittedly difficult, in the current Global climate but it would help to have one regulatory agency step forward as the debt markets champion.
3. *Working in consultation with industry participants* : If India can deepen and strengthen its debt capital market, the results could be significant. Drawing on the cross sectional experience of G7 countries since the 1970s, its estimated that the overall capitalisation of the Indian debt market (including public sector debt) would grow nearly four-fold over the next decade.

4. *Cost of issuance* : If the corporate bond market is to develop, a great deal of attention will have to be given to minimise the issuance cost and the time taken to make public issue.
5. *Market making* : Market making should be encouraged for promoting the corporate debt market. One way is to encourage the investment bankers involved in the placement of the bonds.
6. *Simplify Listing norms* : For already listed entities, there listing norms could be simpler; they should be allowed an abridged version of disclosure. However, companies which are not listed and which are opting for the private placement mode should be subjected to simple disclosure norms.
7. *Developing a trade reporting system* : A mechanism that captures all the information relating to trades in corporate bonds, disseminate the same and keeps a data base of trade history needs to be developed.
8. *Trading, clearing and settlement mechanism* : A robust trading platform would go a long way in enabling efficient price discovery in corporate bonds and also help in creating depth and vibrancy to the market. An efficient clearing and settlement system would further the development of corporate bond markets by reducing the counter party risk and settlement risk.
9. *Creation of Corporate Bond Indices* : A bond index should be created to measure the performance of corporate bonds issued in the country. These indices should also be made investible so that investors can invest in a basket of bonds.
10. *Measures for attracting retail investors* : Regulators and policymakers, especially SEBI have consistently focused on ensuring retail participation in equity markets and had achieved a fair amount of success in the same. Similar measures need to be implemented to draw retail investors to corporate bond markets.

Current Market Scenario: What more to come

1. In August 2016, RBI has issued guidelines on "Enhancing Credit Supply to Large Borrowers through Market Mechanism" and "Large Exposure Framework. The above regulatory developments are significantly positive for growth of debt capital markets,
2. The liquidity in the banking system has improved post demonetisation which would henceforth result in lower deposit and lending rates.
3. In the words of RBI Governor Urjit Patel banks still have the scope to cut loan rates even though demonetisation has already helped faster monetary transmission into interest rates, which has further raised investors' sentiments. According to the depository data, FPIs infused a net sum of Rs. 1,132 crore in equities during April 3-21 and another Rs. 17,758 crore in the debt segment, translating into a combined inflow of Rs. 18,890 crore (\$2.91 billion).
4. Indian capital markets seem to be losing their 'safe haven' status among foreign portfolio investors as they appear headed for nearly USD 2-billion pullout of the so-called 'hot money' 2016, making it the worst period in last eight years in terms of foreign investments. Surprisingly, it is the debt instruments that are taking the biggest hit. There are, however, two recent developments in credit markets that which is

expected to have a longer-term structural impact: extended duration and leverage in the investment grade sector and a liquidity premium in high yield.

Conclusion

Despite a plethora of measures adopted by the authorities over the last few years, India has been distinctly lagging behind other developed as well as emerging economies in developing its corporate debt market. The domestic corporate debt market suffers from deficiencies in products, participants and institutional framework and has not yet reached critical mass. If the authorities can streamline the issuance process and make the public markets attractive to issuers, then the resulting momentum should help to push through the harder and politicized reforms. The small investor attitude towards debt instruments needs change. Development of long-term debt markets is critical for the mobilisation of the huge magnitude of funding required to finance potential businesses as well as infrastructure expansion.

Issues such as crowding of debt markets by government securities cannot be addressed by market participants and regulators alone. Better management of public debt and cash could result in a reduction in the debt requirements of the government, which in turn would provide more market space and create greater demand for corporate debt securities. To conclude by the words of Peter Lynch for better management of the Indian Debt Capital Market "Know what you own, and know why you own it."

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Indian Debt Market : Pillars of the Indian Economy

CS Sachin Sarda*

Introduction

India is the only significant economy that is growing at a pace faster than the pre-2008 financial crisis levels. It is also less susceptible to the continuing rout in commodity markets. This, coupled with the fact that inflation is under control, and India's fiscal deficit is manageable, will keep the economy robust in coming years.

Global factors such as China's painful transition from investment-led to consumption-led growth, expected currency turmoil in West Asia and a recalibration of the commodity-based economies of Russia and Brazil, among others, will continue to make India a relatively attractive investment destination,

Eight years have passed since the 2008 financial crisis and the United States is finally showing signs of recovery. Unemployment is down and job creation is growing. With the Federal Reserve rising interest rates in December, the US is attracting foreign capital quickly. However, there is still a chance for Indian markets to attract global investors. Unlike most other major economies, India is on a high-growth trajectory. Capital that is seeking riskier investments for higher returns is actively looking for better risk-reward opportunities.

The Indian economy relies on government debt

One way that Indian firms and the Government of India (GoI) can attract foreign capital more effectively is through the development of the bond market. Bonds can offer a useful set of securities for investors and allow them to diversify their portfolio of investments in India.

Corporate debt markets provide an extensive set of investing opportunities, with a host of debt instruments (bonds and bond derivatives), offering exposure to the Indian economy. The Government Securities (G-secs) market is fairly developed; about 75% of the Indian market is Government-issued debt. This is unusual. For most other major debt markets, the corporate debt (company issued bonds) portion of it plays a much larger role. Corporate debt markets provide an extensive set of investing opportunities, with a host of debt instruments (bonds and bond derivatives), offering exposure to the Indian economy. Debt markets traditionally offer a less-risky investment than stocks (equity).

Currently, it is mostly only large Indian banks and the government that issue tradable bonds

* Company Secretary cum Compliance Officer. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

in the market. Most other entities use private placements (loans from banks) as debt. India lacks a centralized database for information about tradable bonds and a functional trading platform. There are inconsistencies in how bond prices and yields are calculated and listed.

The debt market in India comprises broadly two segments, viz.

Government Securities Market and Corporate Debt Market. The latter is further classified as Market for:

PSU Bonds and

Private Sector Bonds.

The corporate bond market broadly comprises of corporate sector raising debt through public issuance in capital market and also through private placement basis.

The Indian debt market is a market meant for trading (i.e. buying or selling) fixed income instruments. Fixed income instruments could be securities issued by Central and State Governments, Municipal Corporations, Govt. Bodies or by private entities like financial institutions, banks, Corporates etc. Simply put, a bond/debt can be defined as a loan in which an investor is the lender. The issuer of the bond pays the investor interest (at a predetermined rate and schedule) in return for the amount invested. The Indian debt market offers a variety of debt instruments, offered by the Government and non-Government entities.

Major Players

- State governments and Central government. The largest segment of the Indian Debt market consists of the Government of India securities where the daily trading volume is in excess of Rs.2000 crore, with instrument tenors ranging from short dated Treasury Bills to long dated securities extending up to 30 years. (source: www.dbie.rbi.org.in)
- Non-government entities like Banks, Financial Institutions, Insurance Companies, Mutual Funds, Primary Dealers, Corporate entities.

Instruments

There are a variety of instruments offered in the debt market like:

1. *MIBOR linked bonds*. MIBOR (Mumbai Inter Bank Offered Rate) bonds are closely modeled on the LIBOR (London Inter Bank Offered Rate) bonds. Currently, Reuters and the National Stock Exchange (NSE) are the two calculating agents for the benchmark. The NSE MIBOR benchmark is the more popular of the two and is based on rates polled by NSE from a representative panel of 31 banks/institutions/primary dealers.
2. *Commercial Papers (CPs)*. These are short term unsecured promissory notes, generally issued by corporate entities.
3. *Certificate of Deposits (CDs)*. These are issued by banks.
4. *Treasury Bills*. These are issued by Reserve Bank of India (RBI).
5. *Medium- to long-term bonds*. These are issued by corporate entities/financial institutions. They can feature fixed or floating rates.

6. *Call money market*. This represents overnight and term money between banks and institutions.
7. *Repo transactions*. These represent temporary sale with an agreement to buy back the securities at a future date at a specified price.
8. *Collateralized Borrowing and Lending Obligation (CBLO)*. CBLOs were developed by the Clearing Corporation of India (CCIL) and Reserve Bank of India (RBI). It is a money market instrument that represents an obligation between a borrower and a lender as to the terms and conditions of the loan. The details of the CBLO include an obligation for the borrower to repay the debt at a specified future date and an expectation of the lender to receive the money on that future date, and they have a charge on the security that is held by the CCIL. CBLOs are used by those who are heavily restricted or have been phased out of the interbank call money market.

The other instruments that are prevalent in the debt market are Debentures, Secured premium notes, Deep Discount Bonds, PSU Bonds / Tax-Free Bonds, Floating Rate Bonds, State Government Securities, STRIPS and Interest Rate Derivative products.

The debt market features the usual risks associated with financial securities like:

1. *Credit risk*. While corporate papers carry credit risk due to changing business conditions, government securities are perceived to have zero credit risk. Credit Risk is the risk that the issuer will not pay the coupon income and/ or the maturity amount on the specified dates. Credit Ratings have been established by rating agencies to reflect their opinion of an issuer's ability and willingness to do so.
2. *Interest rate risk*. Interest rate risk is present in all debt securities and depends on a variety of macroeconomic factors. Interest Rate Risk is the risk that interest rates may rise, causing a fall in value of traded debt instruments.
3. *Settlement risk*. The risk that one party will fail to deliver the terms of a contract with another party at the time of settlement is called settlement risk. All debt securities are settled within the specified duration, excepting special cases like death of the holder, etc, in which case it may be delayed till all the required formalities are completed.
4. *Liquidity risk*. The risk arising from the lack of possibility to either buy or sell a security quickly as per one's requirement is called liquidity risk. Debt securities have minimum liquidity risk and can be easily bought and sold after due listing.

Corporate bonds are the key

The most important piece of the need for a better developed bond market in India is access to capital for more firms. Currently only the top-rated borrowers have access to the corporate bond market. Further, banking and financial services account for 74% of primary bond issues in the country. Hence a more developed, unregulated bond market might allow more firms access to cheaper or more efficient debt capital, through a higher risk-taking culture among investors.

On the policy side, Raghuram Rajan, the former RBI Governor, mentioned that bank lending rates are inefficient in passing through changes in the interest rate by the Central

Bank. He has also said that markets reflect interest rate changes more efficiently. Further reforms from the Central Bank are required if more firms are to gain access to the bond market. This comes at a time when the independence of the RBI is constantly questioned in the light of demonetisation in 2016. The government may attempt to protect the traditional public sector banks and hence private debt markets.

It is important to remember that 95% of debt in India is bank loans. Thus, there is a dire need for a more efficient credit market to pass through shifts in monetary policy. This becomes particularly important for infrastructure projects. If they can get access to cheaper capital at interest rates that better reflect monetary policy through tradable bonds, then they might not choose to get bank loans to finance projects. And when infrastructure projects can be financed more efficiently using publicly traded bonds, more of them are executed.

New class of asset

There is a dire need for a more efficient credit market to pass through shifts in monetary policy.

Developed bond markets will create a new asset class in India that attracts foreign capital. It will be an efficient allocator of capital and will bring more firms into the market. To realize these benefits, the RBI took an important step in August 2016 to liberalize bond markets by allowing banks to raise capital through rupee-denominated bonds (Masala Bonds) in foreign markets.

It also allowed both resident and non-resident Indians to maintain big open positions in the bond market. This step will expand the investor base and hence the capital inflow into the economy. With more deposits in banks today than ever before, there is a lot more money available to facilitate this move. And for you, it's a chance to earn high returns on otherwise immobilized money.

India's debt capital markets have grown significantly during the last few years as reflected in the increase in total debt outstanding (sovereign + private sector) to Rs. 106.88 lakh crore as on December 31, 2016 from Rs 45.31 lakh crore as on March 31, 2011 (CAGR of 15 percent during the period).

The amount of corporate debt (including financial sector) has also increased at a steady rate, at a CAGR of 12 percent during the above period growing from Rs 14.2 lakh crore as on March 31, 2011 to Rs 27.9 lakh crore as on December 31, 2016.

"Though the quantum of corporate debt outstanding has doubled, the penetration of the corporate debt market remains low in relation to GDP growth. The corporate debt/GDP has increased by only two percent during these six years; that is, from 17.5 percent of GDP in FY 2011 to 19.5 percent in 9MFY2017." This ratio is significantly lower than in other countries, like China (48 percent) or other smaller economies like Brazil (39 percent), Thailand (48 percent), Malaysia (46 percent) and Singapore (48 percent), reflecting the scope for considerable improvement of issuer and investor participation in the debt markets," said MD and Group CEO ICRA, Naresh Takkar.

The share of capital market borrowings in relation to total bank borrowings has improved from 19 percent in FY 2011 to 27 percent in 9MFY2017.

Notwithstanding, the increased participation from issuers, the broader participation remains subdued with high concentration of debt issuances from few top issuers. The top-10 issuers have consistently accounted for ~50 percent of the total value of issuances, as investors remained inclined towards higher rated borrowers. Of the total value of debt issuances, ~90 percent are from issuers with credit rating of AA- or higher. Similarly, almost 99 percent of the value of commercial paper issuances is from issuers rated A1+; reflecting limited investor's appetite for lower rated papers.

During September 2015, Reserve Bank of India (RBI) had allowed banks to offer partial credit enhancement to corporate bonds and project SPVs. Subsequently, in August 2016, RBI has issued guidelines on "Enhancing Credit Supply to Large Borrowers through Market Mechanism" and "Large Exposure Framework."

As per ICRA's estimates, taking into account a 10 percent annual credit growth in borrowings of these large issuers, it can result in potential additional debt issuances of Rs. 70,000 crore per annum.

"The above regulatory developments are significantly positive for growth of debt capital markets, however with many large issuers, especially in the infrastructure and other capital intensive sectors rated in the lower rating categories; the initial capital market issuances will mainly be for refinancing of operational projects as the investors' appetite for project level entities is expected to remain limited. At the same time, measures towards strengthening the market infrastructure, improving the liquidity in secondary markets and introduction of new products will help make the Indian debt capital market more vibrant," Naresh Takkar.

Transformation in the market structure

The Indian Debt Markets are today poised on the threshold of momentous change and transition to an efficient, transparent and vibrant market with significant retail participation. The first half of the twentieth century had witnessed a significant amount of retail interest and participation in the G-Sec market with more than half the holdings of G-Secs issued being held by retail investors, a trend which continued until the early sixties. The administered interest rate regime and the emergence of other equity and debt instruments led to a gradual diminution in the investor interest and participation in the G-Sec market and made G-sec market a wholesale market with participation largely restricted to the Banks, Institutions and the Primary Dealers. The rapidly expanding volumes in the Wholesale Debt Market over the past few years bear the promise of an immense and attractive financial market with a strong potential for retail participation.

Breakdown of Asia ex-Japan G3 bond market 2018 estimates

<i>COUNTRY</i>	<i>SHARE</i>
China	44%
India	15%
Korea	13%
Singapore	7%

<i>COUNTRY</i>	<i>SHARE</i>
Hong Kong	6%
Taiwan	5%
Thailand	4%
Indonesia	4%
Malaysia	2%
TOTAL	100%

Source: Morgan Stanley report

Mobilisation of Resources can be either for short term or for long term. Economy consists of huge number of enterprises and individuals, requirements of all of them differ. Some have surplus cash to save, while some other needs cash. Some firms/individuals wants to make good there short term liquidity requirements, some wants money for long term capital investment.

So distinction can be made as to period for which one intends to lend or borrow. It means the financial market is categorized into money market and capital markets. In Money market, period involved for funds movement is 1 year or less, while in capital markets period is generally more than 1 year.

Banks basically caters to money market and mobilizes resources from savers to borrowers. It plays significant role in capital markets, as it lends for capital investment purposes. As economy of the country grows, highly specialized institutions comes up which caters exclusively to capital needs and banks continues its money market business. These institutions are known as Capital Market intermediaries.

Conclusion

The Debt Market plays a very critical role for any growing economy which needs to employ a large amount of capital and resources for achieving the desired industrial and financial growth. The Indian economy which has grown at more than 7% p.a. in the last decade and is on the take off stage for double digit growth would have to meet its resources requirements from robust and active debt market in India.

The Indian debt markets with an outstanding issue size of Government securities (Central and state) close to Rs. 19, 74,467 Crores (USD 421.35 billion) and a secondary market turnover of around Rs. 30 lakh Crores (USD 640.20 billion) for the year 2009 is the largest segment of the Indian financial markets. [Source : Reserve Bank of India (RBI) & Clearing Corporation of India Limited (CCIL)].

The Government Securities market called 'G-Sec' market is the oldest and the largest component of the Indian debt market in terms of market capitalization, outstanding securities and trading volumes. The G-Secs market plays a vital role in the Indian economy as it provides the benchmark for determining the level of interest rates in the country through the yields on the government securities which are referred to as the risk-free rate of return in any economy.

Besides G-Sec market, there is an active market for corporate debt papers in India which trade in short term instruments such as commercial papers and certificate of deposits issued by Banks and long term instruments such as debentures, bonds, zero coupon bonds, step up bonds etc. The outstanding issue size of listed corporate debt paper was Rs. 2.2 lakh Crores in 2009 (USD 46.95 billion). [Source : Security & Exchange Board of India (SEBI)].

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Green Bonds - An Instrument for Financing the Future

CS (Dr.) S K Gupta* CS Barkha Chhetri**

Introduction

A bond is a debt instrument with which an entity raises money from investors. The issuer of a green bond publicly states that capital is being raised to fund ‘green’ projects, which typically include those relating to renewable energy, emission reductions and so on. Green bonds are like any other debt instrument but the funds raised from such bond sale are used exclusively for renewable energy projects. There is no common definition of “green” bonds and market practice has been for issuers to choose their own definition. The general idea is that the proceeds from the issue of these types of debt instruments will be used either to fund projects which have a discernible, positive environmental impact, often in the renewable energy sector, or be used to invest in generally ethically sound business lines or assets, such as green residential mortgages or low-emission vehicles. ‘Green bonds’ are an attractive mechanism for organizations to raise capital for sustainable projects. These bonds can be raised by not only financial institutions, but also by any private sector or public sector organization. The global green bond market is growing rapidly which is a result of the interest from a varied debt investors.

An issuer can “label” its bonds as green on the basis of its own criteria or with reference to ‘Green Principles’ developed by the International Capital Markets Association. The GBP have four components: proceeds should be used for projects which meet certain criteria, providing clear, quantifiable environmentally sustainable benefits; the issuer should have a process for evaluating the eligibility of the projects using the proceeds; the proceeds should be appropriately tracked by the issuer in a manner which links back to its green projects; and the issuer should report at least annually on the use it has made of its proceeds. It is then up to investors to do the necessary due diligence to determine whether they agree with that green label on the basis of information disclosed by the issuer, which may include independent analysis given by third parties.

A green bond is a fixed-income financial instrument used to raise funds through the debt market. It is like traditional corporate bonds but the key difference is that green bonds raise funds for projects with environmental benefits. Green bonds were created to fund projects

* Group CEO - AIHP, Gurgaon

** Practising Company Secretary

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that have positive environmental and/or climate benefits. Green bonds are attractively simple structures, offering investors additional disclosure and accountability and providing a means to ring-fence funds for investments in activities promoting sustainable development.

Green Bonds Principles' definition of Green Bonds

Green bonds are any type of bond instruments whose proceeds will be exclusively applied to finance or re-finance, in part or in full, new or existing eligible projects that will promote progress on environmentally sustainable activities.

Potential eligible projects explicitly recognized by the Green Bonds Principles (GBP) include:

- Renewable energy
- Energy efficiency (including efficient buildings)
- Sustainable waste management
- Sustainable land use (including sustainable forestry and agriculture)
- Biodiversity conservation
- Clean transportation
- Sustainable water management (including clean and/or drinking water)
- Climate change adaptation

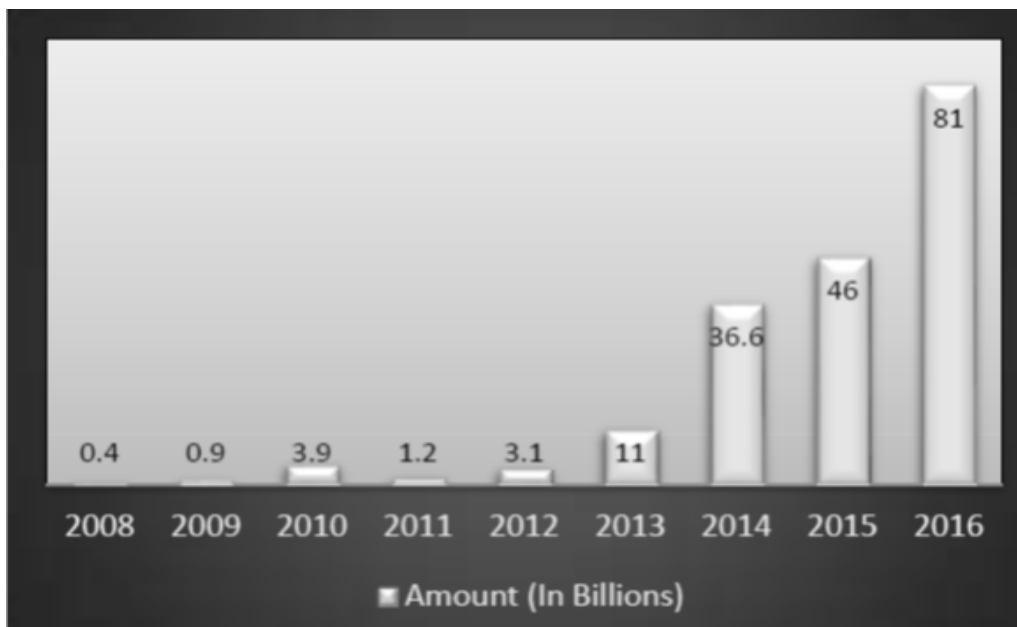
There is no common definition of “green” bonds and market practice has been for issuers to choose their own definition. The general idea is that the proceeds from the issue of these types of debt instruments will be used either to fund projects which have a discernible, positive environmental impact, or be used to invest in generally ethically sound business lines or assets, such as green residential mortgages or low-emission vehicles. An issuer can “label” its bonds as green on the basis of its own criteria or with reference to published green principles. It is then up to investors to do the necessary due diligence to determine whether they agree with that green label on the basis of information disclosed by the issuer, which may include independent analysis given by third parties.

The market does not need a single definition of greenery. But it does need to strike a balance between accepting anything (which would dilute the attraction of green bonds as instruments to diversify climate risk) and being so strict that hardly anyone can meet the criteria.

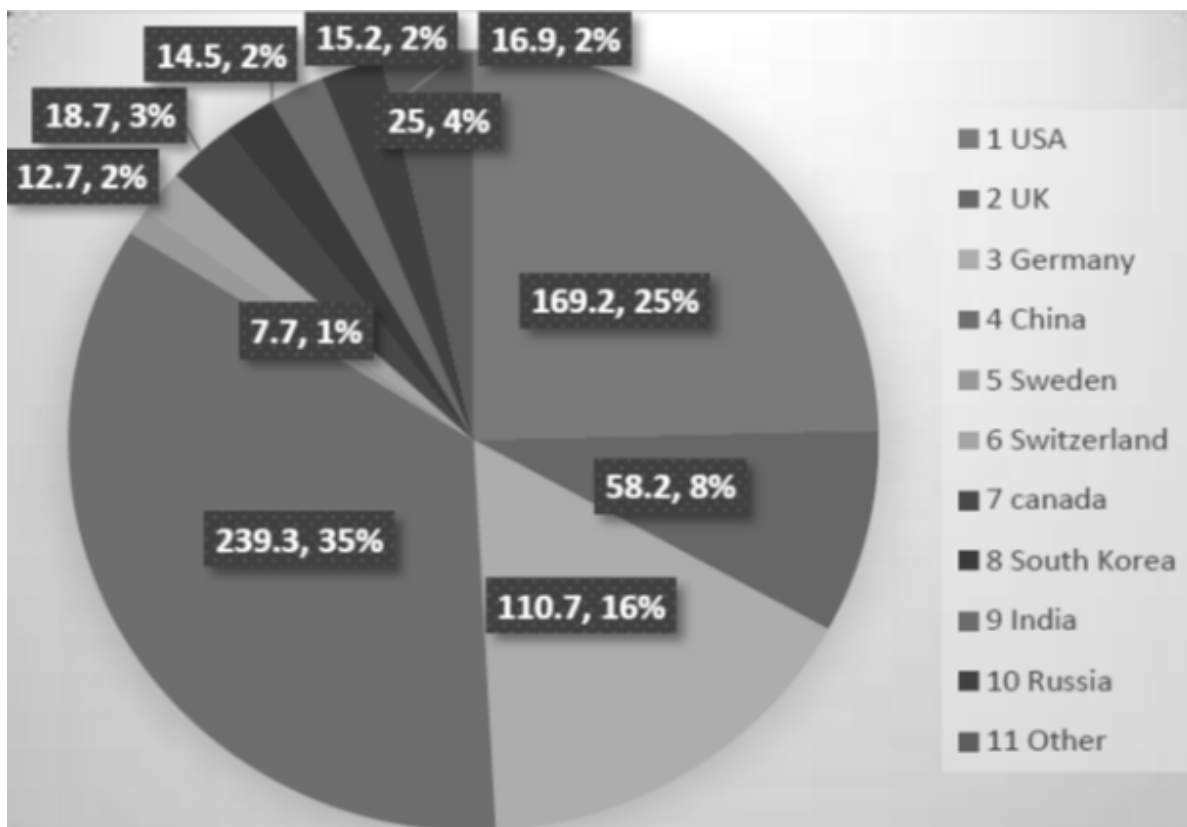
Emergence of Green Bonds

The first green bond was issued in 2007 and was initially characterized as a niche product pioneered by a handful of development banks. The “Climate Awareness Bond” was issued by the European Investment Bank (EIB) in 2007, followed by the World Bank issuing a “Green Bond” in 2008. Between 2007 and 2012, governments began to join international organizations and issue their own green bonds.

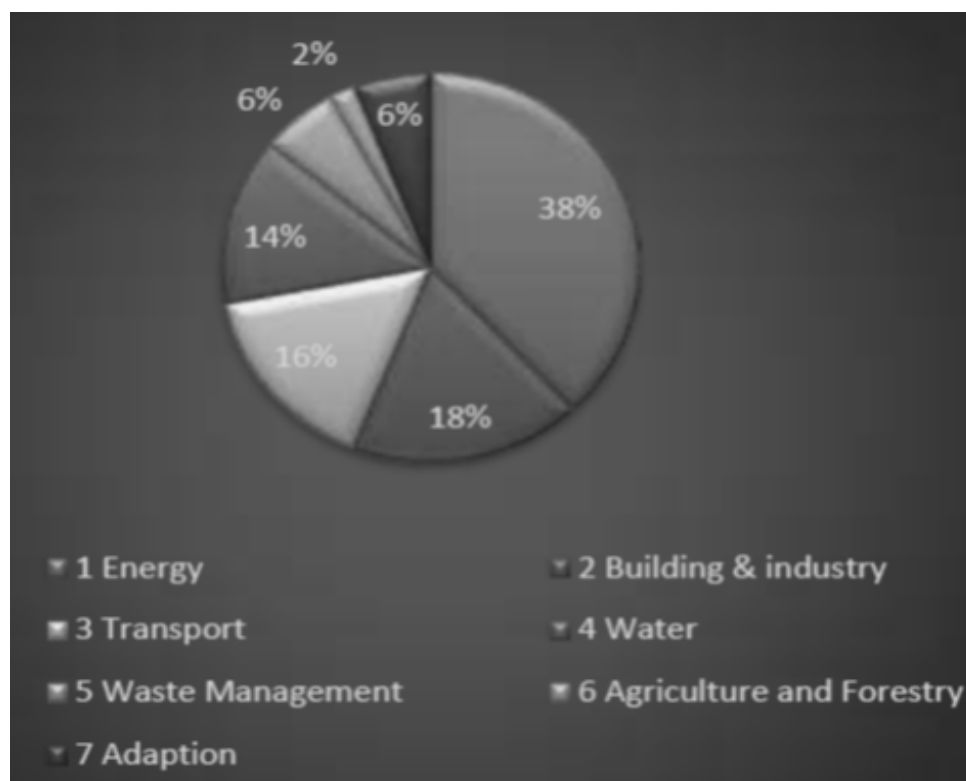
Funds raised through Green Bonds globally



Funds raised through Green Bonds in 2016



Use of Green Bond proceeds in 2016



Luxembourg Stock exchange has launched world's first 'Green Bond' platform for trading environmental friendly securities. So-called green bonds, which will be traded in a new market known as the Luxembourg Green Exchange, are meant to only raise money that is used for environmental friendly purposes.

Green Indexes spurt

Four index providers have launched green bond indexes viz. BofA Merrill Lynch Green Bond Index, Barclays MSCI Green Bond Index, S&P Green Bond Index, and S&P Green Project Bond Index. These indexes provide transparency to the rapidly changing market and serve as a barometer of its growth as it evolves in diversity of issuers, types of bonds, maturity, credit ratings, and sectors. The market is too new, however, for the indexes to fully function as asset class benchmarks. These indexes are not fully investable, for instance, and their limited performance history and rapidly changing composition yield little information for risk metrics and return expectations.

But why should investors be interested in green bonds in the first place? The number of investors concerned about the environmental footprint of their portfolio is constantly rising, and many are starting to integrate environmental, social and governance (ESG) issues into their valuation models. Further, in this negative-yield bond era, green bonds represent quite a good deal: 82% of them are rated at investment grade, they satisfy the medium-long term preferences of institutional investors, and they cover a wide range of sectors.

Value Proposition: Why Green Bonds are an effective financial instrument to support clean energy development

- Green bonds create investment pipelines to meet climate commitments.
- Unlike many other sustainability initiatives, they focus on the performance of assets (as opposed to a corporate entity or fund) – so they present a real opportunity to understand how assets perform and compel the issuer to set ambitious targets for improvement.
- The rules governing the ‘use of proceeds’ mean that the investment gained through the issuance of bonds must be used on that particular asset to improve its performance so there is a direct relationship between the investment and the assets’ performance.
- The lifetime of the bond can enable the issuer to take a longer-term approach to investment in assets.
- Green bonds expand the quantum of clean energy finance and broaden investor base.
- Green bonds increase liquidity and drive green investment by enabling refinancing.
- Green bonds provide access to low cost, long term capital.

Green Bonds - Is it worth it?

- The basic principle behind ‘green bonds’ is ‘greenium’, or the premium an investor is willing to pay for green projects. This means that investors settle for lower returns, resulting in cheaper financing for green projects.
- Green bonds can also enhance an issuer’s reputation. Issuing a green bond is an effective way for an organization to demonstrate its green credentials by showing its commitment to the environment and improving its own environmental performance.
- The process of issuing and managing the proceeds of a green bond can improve awareness within the organization of the issuer’s sustainability goals.

Challenges in Issuance of Green Bonds

- Use of proceeds: the issuers need to define and disclose their criteria for what is considered ‘green’ i.e. what projects, assets or activities will be considered ‘eligible’ and what funds will be spent on.
- Project evaluation and selection: what process will be used to apply ‘green’ criteria to select specific projects or activities.
- Management of proceeds: what processes and controls are in place to ensure funds are used only for the specified ‘green’ projects.
- Reporting: how projects will be evaluated and progress reported against both environmental and financing criteria.

The risk of ‘green washing’

The lack of standard definitions of what makes a bond ‘green’ has led to uncertainty over whether all green bonds really are ‘green’. Issuers face reputational risk and potential

accusations of 'greenwash'. Greenwashing occurs when a bond's proceeds are used to fund projects with little or no positive environmental impact. To prevent the risk of greenwashing, companies are advised to be guided by the two sets of currently available standards which define and regulate green bonds (1) The Green Bond Principles are voluntary guidelines issued by the International Capital Market Association which states the procedure for certifying a green bond, which have been adopted by 50 large issuers, underwriters and investors. They set disclosure criteria and where the money can go. An external consultant can provide a second opinion on the bond structure and on the projects financed (2) The Climate Bond Standards have been put forward by the Climate Bond Standards Board, an organization of funds that have among them around \$35 trillion.

At present, market practice has been not to include covenants or events of default in green bond documentation which would penalize an issuer for failing to apply the proceeds of its bond issue towards the specified green use, so documentation has not given investors much comfort that issuers will abide by their stated principles. However, the big four audit firms and external, independent consultants or assessors are often engaged to provide opinions certifying that certain bonds meet the GBP.

One of the slightly more complicated challenges is 'do investors really care?' Having made the initial investment in a green bond, how many investors track the bonds' performance against its 'green credentials'? The ability of the investor (particularly in the debt market) to engage in any great detail is limited – not only in terms of the time they can afford to interrogate the sustainability performance of the assets, but also in terms of their sustainability knowledge.

Greening India's Financial Market

The Government of India has embarked on an ambitious target of building 175 gigawatts of renewable energy capacity by year 2022, from just over 30 gigawatts now. This ambitious target needs ambitious investments. It is estimated that this leap towards renewable energy will require funding of US\$200 billion. Green bond funding is crucial for India to achieve its green goals. Green bonds are becoming an increasingly attractive mechanism for both private and public sector organizations to raise capital for projects, assets or other activities that benefit the economy, environment and society. With the Indian government and private sector increasingly focusing on renewable energy projects, the demand for such funds is expected to rise over time.

Currently, most renewable projects are financed by bank commercial loans at 11-12 per cent interest per annum. The Indian banking sector is currently going through a balance sheet adjustment; banks are unlikely to be able to expand their balance sheets to be able to finance the additional requirements of the renewable sector. Green bonds may be able to fill this gap.

Green bonds are an attractive mechanism for organizations to raise capital for sustainable projects. These bonds can be raised by not only financial institutions, but also by any private sector or public sector organizations. Indian companies are beginning to embrace green finance to fund environmentally friendly projects, as they heed calls from Prime Minister Narendra Modi to boost renewable energy in one of the world's worst polluting nations and tap rising investor demand.

Green Bonds issued in India

- In 2015, YES Bank, India's Private Sector Bank has successfully issued India's first evergreen infrastructure bonds raising an amount of INR 1,000 crores. The amount raised is being used by YES Bank to finance green infrastructure projects in renewable energy including solar power, wind power, biomass, and small hydropower projects.
- Another leading banking institution, the Exim Bank of India, in March 2015, issued a five-year \$500 million green bond, which is India's first dollar-denominated green bond to fund eligible green projects in countries including Bangladesh and Sri Lanka.
- Axis Bank has launched India's first internationally-listed and certified green bond and raised \$500 million to finance climate change projects and solutions around the world. The bond certified by the Climate Bonds Standards Board (CBSB) has been listed in London Stock Exchange (LSE). The Axis Bank will utilise the bond proceeds to promote green energy in urban and rural areas, transportation and what is called 'green-blue infrastructure' projects in India and abroad.
- Exim Bank issued India's first ever and Asia's second dollar-denominated green bond in March 2015 raising \$500 million through international investors
- IDBI Bank raised \$350 million in BBB-rated 5-year green bonds for renewable energy projects in November 2015.
- In January 2016, IREDA issued a tax-free Rs.10 billion green bond
- CLP Wind Farms, the largest wind power developer in India with 1,000 MW of wind energy assets in the pipeline across 6 states, became the first Indian corporate (non-bank) issuer of green bonds in September 2015. CLP Wind Farms raised Rs.6 billion.
- ReNew Power Ventures, a leading Indian clean energy company, issued the second corporate green bond in the country in September 2015. The proceeds of the Rs.4.51 billion green bond is intended to refinance bank loans for the company's 85 megawatts (MW) wind power plant in Maharashtra.
- Hero Future Energies, the green energy arm of the Hero Group, one of India's leading industrial conglomerates, issued the country's first certified climate bond in February 2016. Hero Future Energies raised Rs.3 billion (\$44 million) by issuing non-convertible debentures – certified by the Climate Bonds Standard – to finance the development of wind energy projects in the states of Madhya Pradesh, Telangana, and Andhra Pradesh
- India's state-owned energy major NTPC has become first Indian corporate to raise \$300 million through Green Masala Bond listed at the London Stock Exchange (LSE) as part of its efforts to promote renewable energy projects in the country. The first Masala bond by an Indian quasi-sovereign issuer, represents another historic event for Indian finance.
- Motherson Sumi and Greenco Investment company have also raised funds through green instruments

SEBI Concept paper on issuance of Green Bonds

In January 2016, Securities Exchange Board of India (SEBI) rolled out a path breaking concept paper defining the guidelines for issuance and listing of Green Bonds, as increasing

number of financial and banking institutions in India have shown interest in launching green bonds to mobilise resources to support wide range of projects related to renewable energy and climate change adaptation and mitigation.

Issuance of Green Bonds in India does not require any amendment to the existing SEBI regulations for issuance of corporate bonds, SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (hereinafter “ILDS Regulations”). The issue, listing and disclosure requirements as prescribed under ILDS Regulations will continue to be applicable, like any regular corporate bond issuance.

However, for designating an issue of corporate bonds as green bonds, in addition to the compliance with the requirements under ILDS Regulations, an issuer shall have to disclose in the offer document following additional information about the green bonds, which have been based upon the Green Bond Principles, 2015:

- (A) *Use of proceeds* :Issuer shall define and disclose in their offer document, the criteria for identification as ‘green’ i.e. what projects, assets or activities will be considered ‘eligible for financing’ and quantum of funds to be spent on the projects/assets/activities. For assigning the status of the bonds as Green, the broad categories of areas where such monies may be invested may be one or more of the following:
- Renewable and sustainable energy (wind, solar etc.)
 - Clean transportation (mass transportation)
 - Sustainable water management (clean and/or drinking water, water recycling etc.)
 - Climate change adaptation
 - Energy efficiency (efficient and green buildings)
 - Sustainable waste management (recycling, waste to energy etc.)
 - Sustainable land use (including sustainable forestry and agriculture, afforestation etc.)
 - Biodiversity conservation

However, it is to be noted that this is an indicative list and may include other categories as specified by Board. Further, an issuer, if proposes to utilize a proportion of the proceeds of the issue of Green Bonds, towards refinancing of existing green assets, it shall be clearly provided in the offer document and wherever possible, shall also provide the details of the portfolio/assets/projects which are identified for such refinancing.

- (B) *Project evaluation and selection* :The issuer of a Green Bond shall provide the details of decision-making process, it will/has followed for determining the eligibility of projects for using Green Bond proceeds. An indicative guideline of the details to be provided is as under:
- process followed/ to be followed for determining how the project(s) fit within the eligible Green Projects categories;

- the criteria, making the projects eligible for using the Green Bond proceeds; and
 - environmental sustainability objectives.
- (C) *Management of proceeds* :The proceeds of Green Bonds shall be credited to an escrow account, and shall be utilized only for the stated purpose, as in the offer document. The use of proceeds shall be tracked as per an approved internal policy of issuer and such policy shall be disclosed in the offer document/placement memorandum. The utilization of the proceeds may also be verified/supplemented by the report of an external auditor, or other third party, to verify the internal tracking method and the allocation of funds towards the projects, from the Green Bond proceeds.
- (D) *Reporting* : In addition to reporting on the use of proceeds issuers shall also provide, at least on an annual basis, a list of projects to which Green Bond proceeds have been allocated. This may also include the details of the expected environmental impact of such projects.

The environmental impact report may provide for qualitative performance indicators and, where possible, quantitative performance measures of the expected environmental sustainability impact of the specific project. However, where confidentiality agreements or competition issues limit the amount of detail that can be made available, information can be presented in generic terms.

Unlocking the full potential of Green Bonds

Green bonds are vital for the future of a sustainable economy, but not everything labelled ‘green’ fulfills its promise. There must be robust standards to ensure that people get what they expect. Vigorous, credible, fully-developed and widely-accepted industry standards for green bonds are urgently needed to ensure that the market thrives and the sustainable economy grows. Only a bond for which the issuer can demonstrate measurable environmental benefits, certified by an independent party according to such widely-accepted, fully developed standards, should qualify as a green bond. Bonds which do not meet these standards could undermine the credibility of the entire green bond market.

The lack of standard definitions of what makes a bond ‘green’ has led to uncertainty over whether all green bonds really are ‘green’. Issuers face reputational risk and potential accusations of ‘green wash’. Green washing occurs when a bond’s proceeds are used to fund projects with little or no positive environmental impact. Green bonds can also enhance an issuer’s reputation. Issuing a green bond is an effective way for an organization to demonstrate its green credentials by showing its commitment to the environment and improving its own environmental performance. The process of issuing and managing the proceeds of a green bond can improve awareness within the organization of the issuer’s sustainability goals.

Green bonds are currently moving toward the predictability that investors want. They have already passed through what we term the “incubation” and “early adopter” phases, and are currently in the “excitement” phase. Their use is expanding rapidly, but awareness is still limited and several questions about standards remain unresolved. Governments, banks, and others can help speed green bonds’ movement into the mainstream by establishing clearer certification and ratings systems, issuing more of them, and educating the public about their financial and environmental benefits.

To enter the mainstream, the green bond market will need to foster an increased awareness of what green bonds are and why they are an easy and beneficial investment. This could be achieved by offering green bonds to investors as part of a regular investment portfolio, building out green finance curricula in schools, or offering green bond education to people who are directly involved with fixed income investments. Financial service providers, colleges and universities, and others all can play a role.

Green bonds are a sustainable way of financing green projects. To achieve India's clean energy and climate goals, new innovative financial instruments (such as green bonds) that tap into international resources to leverage a wider investor base (such as pension funds, sovereign wealth funds and insurance companies) need to scale up:

- Financial skills training and awareness to attract prospective borrowers unfamiliar with green bonds;
- Credit enhancement products by green banks and industry leaders to bring new issuers on board; and
- Simplification and standardization of the issuance and compliance process to increase the transparency and reach to new investors in India and internationally.

The scope of improvement in Indian green bond market is expanding rapidly. What is needed is the policy initiatives supplemented with tax benefits, interest subsidies and capital relief to the issuers as well as investors. Some of the key actionable steps would be changing Insurance Regulatory and Development Authority norms for size of investment for insurance companies, creating mandates for provident funds to invest in infrastructure and environmentally sustainable projects, increasing the priority sector lending limit for bank loans under solar energy from a meagre Rs.15 crore, standardizing the definition of green to be able to target government efforts in the direction, and mobilizing retail savings by way of tax exemption on the lines of Section 80CCF.

It is expected that guidance over the use, management and reporting of green bond proceeds and project performance monitoring would be progressively developed and documented and that will help the green bonds achieve mainstream acceptance in the next five years or so. Investors are progressively looking at opportunities to decarbonize their portfolios. But for this to happen, Green bonds will have to become less exciting, more "boring" and predictable, and more ingrained into the financial services system. Going forward, there is a risky "valley of death" that all relevant stakeholders need to leap over. Striking the right balance between yield, risk, environmental integrity and public confidence in the market requires aligned incentives for all participants: banks, investors, issuers, verifiers and regulators.

Green bonds can drive the next great transformation towards greening of capitalism. Green bonds can be used as strategic financial instruments to finance the transition towards a lower-carbon economy. The time is ripe for change. Climate change has become a defining issue for financial stability, due to physical risk, liability risk and transition risk. Green bonds can help break the tragedy of the horizon by connecting present and future generations.

Gearing up for Green bonds

In January 2016, Securities & Exchange Board of India (SEBI) rolled out a path breaking

concept paper defining the guidelines for issuance and listing of Green Bonds, as increasing number of financial and banking institutions in India have shown interest in launching green bonds to mobilise resources to support wide range of projects related to renewable energy and climate change adaptation and mitigation.

Green bonds are a game changer in financing of sustainability projects. Green bonds are a low carbon economy driver. Investors are progressively looking at decarbonizing their investment portfolio. As investments in green bonds grow, quality of life and health will improve ultimately leaving the world a much better place.

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Derivatives - An Effective Tool in Capital Markets

CS Parthasarathy R*

What is a derivative ?

A derivative can be defined as a financial instrument whose value depends on (or derives from) the values of other, more basic, underlying variables.¹

The above definition, though defines the basic structure, has its own ambiguities. Hence a broader definition incorporating all the facets of the derivative assumes importance. Broader definition is obtained in Accounting standard – 30² which defines a derivative as:

a financial instrument or other contract within the scope of this Standard (see paragraphs 2-6) with all three of the following characteristics:

- (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’);
- (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- (c) it is settled at a future date.

Thus the definition given in the Accounting Standard – 30 is more comprehensive than the earlier definition. Again the conjunction used after the (b) above is “and”. It signifies that the three conditions supra are cumulative and not alternative. Thus all the three conditions need to be fulfilled for a financial instrument to be considered as derivative.

Implications of definition

First characteristic defines the requirements of a derivative as envisaged in the previous definition in a more detailed purview. Second characteristic indicates that there is no initial investment is either not required or is not comparatively smaller than those required for other types of contracts. Third characteristic requires that the transaction is settled at a future. Thus it precludes all transactions which are settled on the spot basis viz. intraday, roll over settlement etc.

* B.Sc., ACMA, ACA, Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

Now the crucial question comes to our mind as to what is meant by “financial instrument”. Again going back to the Accounting Standard – 31³ which gives the definition as under:

“A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.”³

Definition of Financial Assets and Financial Liability

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity’s own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments.

A financial liability is any liability that is:

- (a) a contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- (b) a contract that will or may be settled in the entity’s own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity’s own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments.

Thus the definition of the derivative is exhaustive under the Accounting Standard – 30 and Accounting Standard – 31.

Having defined the term derivative, we can now go through some of the terms associated with derivatives. In any derivative, a person will be selling an asset and the other party will be buying the contract. In derivatives, the process of selling is called “taking a short position” or simply “shorting”. Similarly, the process of buying is called “taking a long position” or simply “longing”.

History of Derivatives in India

Derivatives markets is neither new to India nor can be said that it has entered in the past 2-3 decades. India have been in existence in one form or the other for a long time. It was in the year 1875 that the Bombay Cotton Trade Association started futures trading in commodities. The turning point in this direction was in the year 1952 when the Central Government banned cash settlement and options trading.

Eventually this forced the market leaders to shift to informal forwards markets. Consequent of the India’s entry into the GATT agreement and shifting to Global Markets, policy has shifted in favour of an increased role of market-based pricing and less suspicious derivatives trading.

The first radical step taken in this direction was the promulgation of the Securities Laws (Amendment) Ordinance, 1995. It provided for withdrawal of prohibition on options in securities. Last decade, especially post 2000, saw lifting of ban on futures trading in many commodities. Around the same period, national electronic commodity exchanges were also set up.

The chronology of history of derivatives market thus is as under:

- (1) In June 2000, SEBI accepted the recommendations of L C Gupta Committee and granted the approval with effect from May 2001.
- (2) SEBI approved trading in index futures contracts based on various stock market indices such as, S&P CNX, Nifty and Sensex. Subsequently, index-based trading was permitted in options as well as individual securities.
- (3) The trading in BSE Sensex options commenced on June 4, 2001 and the trading in options on individual securities commenced in July 2001.
- (4) Futures contracts on individual stocks were launched in November 2001.
- (5) The derivatives trading on NSE commenced with S&P CNX Nifty Index futures on June 12, 2000.
- (6) The trading in index options commenced on June 4, 2001 and trading in options on individual securities commenced on July 2, 2001.
- (7) Single stock futures were launched on November 9, 2001.
- (8) The index futures and options contract on NSE are based on S&P CNX. In June 2003, NSE introduced Interest Rate Futures which were subsequently banned due to pricing issue.

<i>Date</i>	<i>Activity</i>
14th December 1995	NSE asked SEBI for permission to trade index futures
18th November 1996	Committee under the Chairmanship of Shri. L C Gupta was constituted by SEBI
11th May 1998	Shri L C Gupta Committee submitted the report
7th July 1999	Reserve Bank permits for OTC forward rate agreements and interest rate swaps
24th May 2000	Nifty was chosen as Indian index for trading futures and options
25th May 2000	NSE and BSE was permitted by SEBI to do index futures trading
9th June 2000	BSE Sensex futures commenced at BSE
12th June 2000	Nifty futures commenced at NSE
June 2001	Equity Index Options began at NSE
July 2001	Stock Options began at NSE
9th November 2002	Single Stock Futures began at NSE
June 2003	Interest Rate Futures began at NSE
13th September 2004	Weekly options at BSE
1st January 2008	Trading of Mini Sensex at BSE
1st January 2008	Trading of Mini Index Futures and Options at NSE
29th August 2008	Trading of Currency Futures at NSE
2nd October 2008	Trading of Currency Futures at BSE

Kinds of Derivatives

Derivatives can be broadly classified into two categories – Futures and Options.



Futures:

Forward Contract is also a derivative wherein there is an agreement to buy or sell an asset

at a certain future time for a certain price. It is usually between two financial institutions or between a financial institution and one of its clients. One of the parties to a forward contract assumes a long position and agrees to buy the underlying asset viz., the foreign currency, on a certain specified future date for a certain specified price. The other party assumes a short position and agrees to sell the same asset on the agreed date and price.

Like a forward contract, a futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future for a certain price. However, futures contracts are normally traded on an exchange.



Options

Option is also a derivative which is settled by either buying or selling a pre-determined asset at a pre-determined date at a pre-determined price. But unlike futures which is an obligation to enforce the agreement, option as its name suggests is an agreement without an obligation or necessity to enforce it.

Options can be divided into two groups – call option and put option.

A call option gives the holder the right to buy the underlying asset by a certain date for a certain price. A put option gives the holder the right to sell the underlying asset by a certain date for a certain price. The price mentioned above is called the “exercise price” or “strike price”. The date in the contract is called the “expiration date” or “maturity”.

In terms of the date of exercise, options are again classified into two groups viz., American options and European options. This kind of nomenclature has nothing to do with the geographical location of the options. Thus, American Option is the which can be exercised at any time up to the expiration date and European option is the one can be exercised only on the expiration date.

Distinction between Futures and Options

Basic distinction between Futures and Options is that Options always involve the payment of Up-front fees. This fees is necessarily payable for the options contract to be entered into. This is non-refundable in case of non-exercise of options at the expiry date.

Classification of Traders

Traders can be classified into three categories viz., hedgers, speculators, and arbitrageurs.

Hedgers use derivatives to reduce the risk that they face from potential future movements in a market variable.

Speculators use them to bet on the future direction of a market variable.

Arbitrageurs take setting positions in two or more instruments to lock in a profit.

Hedging for reduction of risks

Forward contracts are rather a simple form of futures contract. Forward contracts are a form of derivative which provides a neutralization of the effects of the fluctuations in the price of the underlying asset. It is a form of hedging wherein the price is pre-fixed for a particular date.

But how hedging is done through options. Let us illustrate through an illustration.

Illustration for Hedging using options

Mr. A holds 1,000 shares of one particular stock. Market lot of the stock is 100 shares. Thus there are 10 lots of the particular stock.

Let the spot market price as on date is Rs.200 per share. Mr. A wants to sell the shares after two months and he is in the fear that the value of stock is likely to go down. How to protect against falling prices ?

As said earlier, options involve payment of up-front fees. Let us assume that the upfront fee is Rs.10 per share. Option is to sell the shares at Rs.200 per share. There would be 10 option contracts and cost of each option contract would be Rs.1000 and the total cost would be Rs.10,000.

Thus the cost of the entire strategy is Rs.10,000. Three possible situations may arise:

- (1) Price may be more than Rs.200
- (2) Price may be less than Rs.200
- (3) Price may be equal to Rs.200

Situation – 1

If the price is more than Rs.200 but less than Rs.210, option may not be exercised and there would be net loss. For e.g., if the market price is Rs.208 per share, then the total realization would be Rs.208,000 less Rs.10,000 which would be equal to Rs.198,000 amounting to Rs.198 per share.

Situation – 2

If the price is more than Rs.210, then no loss is incurred due to non-exercising of option but the upfront costs reduce the profits.

Situation – 3

If the price is less than Rs.200, up to Rs.190 per share, then the option would be exercised. Here the realization would be Rs.200,000 less Rs.10,000 upfront fees amounting to Rs.190,000.

Situation – 4

If the price is less than Rs.200 and falls below Rs.190, then the option would be exercised and the realization would be greater than the price that would have been received had the securities are sold at the market price.

Options differ from forward contracts in as much forward contracts neutralize risks whereas options provide an insurance cushion to the risks involved.

Speculation using Futures

A speculator in an international market wants to buy £100,000 on the hope that the GBP will strengthen to relative to the US Dollar over the next two months by USD 1.40. Assume, today, 23rd of June 2017, the USD/GBP = USD 1.30.

The amount in GBP needs to be kept in an interest bearing amount till the period of its utilization. Assume that the interest is 3% per annum. Thus the interest for two months would be GBP 500. Corresponding interest in USD is 12% (say)

There are two possible options viz.,

(1) Either to borrow USD 130,000 and buy GBP 100,000.

In this case, it requires an initial investment of USD 127,000.

Alternatively, the speculator can take a long position to buy at USD 1.10) in two contracts having an initial upfront fee of USD 10,000 per contract. Thus an initial investment of USD 10,000 is required as against USD 127,000 less the interest earned in the first alternative.

Profit matrix is calculated as under :

Market price at the end of two months cannot be ascertained precisely and it may either increase or decrease.

The following are the different scenarios of profit statement:

Scenario – 1

When the GBP is acquired through borrowed funds:

	<i>Spot price after two months</i>	
	<i>1.40</i>	<i>1.20</i>
Investment	(-) 130,000	(-)130,000
Realization	140,000	130,000
Interest earned	700	600
Profit	10,700(-)	600

Interest earned is calculated as under:

$$£100,000 \times 3\% \times 2/12 = £500$$

$$£500 \times \text{USD } 1.40 = \text{USD } 700$$

$$£500 \times \text{USD } 1.20 = \text{USD } 600$$

Scenario – 2

When speculation is hedged using futures:

	<i>Spot price after two months</i>	
	1.40	1.20
Initial margin(-)	10,000	(-)10,000
Purchase price	(-) 110,000	(-) 110,000
Realization	140,000	130,000
Interest earned	2,400	2,400
Profit	2,400	12,400

Interest earned is calculated as under:

Funds available = 130,000

Less: paid as initial margin = 10,000

Available for investment = 120,000

This money would have been invested for two months. Hence the interest received in USD would be:

USD 120,000 x 12% x 2/12 = 2,400

Initial Margin and the agreed rate of purchase determine the profitability of the futures.

Speculation using options

Options are widely used in speculative transactions. In fact, option is a more comfortable tool, as it, unlike futures, do not have any obligation. How the option is utilized in speculation is described by the following example:

Illustration

An investor wants to buy 1000 shares. Current price is Rs.20, expected price at the end of the two months' period is Rs.30, Strike price is Rs.23 and price to purchase the option is Re.1 per share.

Investor expects the price to increase. But depending upon the market conditions, it may even decrease.

Assume two alternative market strategies viz., price rise to Rs.30 as expected and price plummets to Rs.15 per share.

Now there are two alternatives:

(1) Purchase the share at Rs.20 and hold.

Investment – Rs.20 x 1000 = Rs. 20,000

Scenario – 1

Realization – Rs.30 x 1000 = Rs.30,000

Profit – Rs.10,000

Scenario – 2

Realization – Rs.15 x 1000 = Rs.15,000

Loss – Rs.5,000

(2) Purchase 2000 options at Re.1 each.

Options price – 2000 x Re.1 = Rs.2,000

Cost of shares – Rs.22.50 x 1000 = Rs.22,500

Realization – Rs.30 x 1000 = Rs.27,000

Profit – Rs.5,500

Options price – 2000 x Re.1 = Rs.2,000

The investor will not exercise the option at all. Hence, the net loss would be Rs.2,000.

Arbitrageurs

Arbitrageurs are a third important group of participants in futures, forward, and options markets. Arbitrage involves locking in a riskless profit by simultaneously entering into transactions in two or more markets.

Let us illustrate the arbitrage by way of illustration:

A share costs \$140 in Wall Street and £100 in London and the exchange rate is \$1.4400 per GBP.

Arbitrageur buys simultaneous 100 shares at \$140 in New York and sells 100 shares at £100 in London.

Thus,

Cost of buying = \$140 x 100 = \$ 14,000

Sales realization = £100 x 100 = £10,000 or £10,000 x 1.4400 = \$14,400

Thus the profit would be \$400

The profits calculated above are assumed to happen without transaction costs. Often the profit on these transactions is subsumed by transaction costs. Thus small investors generally sustain loss or very lesser profits. However, large investors for whom the transactions costs are very much lower as compared to operations, the arbitrage opportunity is very attractive.

Again, the arbitrage is very much subject to basic laws of economics viz., supply and demand theory and cannot last longer.

Purchase of shares at New York will push the demand for USD upwards and this would result in increase in price of the stock.

Similarly sale of the stock would pull the Sterling down. This results in both the USD and GBP settling down at the current exchange price.

Role of derivatives in engendering growth of business in India

In what way does the derivatives contribute to the growth of business in India? This is often repeated question among the business society. The most important thing which directly

affects the business is the uncertainty about the future in terms of pricing, cost and the consequential profit or loss associated with it. Perhaps the important thing associated with those uncertainties is to how to protect themselves from such eventualities. Let us illustrate as to how the derivatives can help in this regard by taking the following cases:

Metal Sector⁵

Let us illustrate with an example. Assume A in the vessels manufacturing industry and is in need of 1000 Kilograms of copper in the month of 1st of August 2017. Price of copper as on 1st of July 2017 is Rs.390 per kilogram and the agreed futures price for August delivery is Rs.380 per kilogram.

There are two options available – either A can buy copper on 1st August 2017 at the prevailing spot price or he can go in for a futures contract.

Purchasing at spot price in August

Total cash outflow = Spot price of the metal per kilogram x 1000 kilogram.

Entering into futures contract

The whole idea of futures contract is to agree to a price which is as close to the spot price in August as possible.

What would be the possible spot price in August ? It may be more than Rs.380 or less than Rs.380.

If it is more than Rs.380 say Rs.390 i.e., at the same level as that July. Since the agreed futures price is Rs.380, gain from the futures transaction would be $(Rs.390 - Rs.380) \times 1000 = Rs.10,000$. At the same time A pays Rs.390 per kilogram, the cash outgo would be $Rs.390 \times 1000 = Rs.390,000$. Net cash outgo would be $Rs.390,000 - Rs.10,000 = Rs.380,000$. Thus the excess price paid due to non-reduction in market price is offset by the profit in futures transactions.

In case the spot price is less than Rs.390, say Rs.370. Since the agreed futures price is Rs.380, loss from the futures transactions would be $(Rs.380 - Rs.390) \times 1000 = Rs.10,000$ (Loss). At the same time, A pays Rs.370 per kilogram, the cash out go would be $Rs.370 \times 1000 = Rs.370,000$. Net cash outgo would be $Rs.370,000 + Rs.10,000$ (Loss) = $Rs.380,000$. Thus the profit gained due to reduction in market price is offset by the profit in futures transactions.

One can argue as to why A has to incur a loss of Rs.10,000 in the situation when the price goes down. The whole idea of entering into a futures contract is akin to an insurance cover. It covers the potential fluctuations in the market price which is uncertain and which cannot be predicted with reasonable certainty.

Entering into Future Options (call option)

Unlike future contracts, where it is obligatory to enforce the agreement, option as the name suggest is optional. How future options is exercised in business to hedge the uncertainties in the market price is explained by way of an illustration with the same set of data as in the previous illustration.

Future call option contract size – 250 kilograms

Strike price in August – Rs.400 per kilogram

Last closing price of call option – Rs.390 per kilogram

Future price in August – Rs.410 per kilogram.

Current futures price – Rs.402 per kilogram.

If the option is exercised

Amount receivable = (Rs.410 – Rs.400) x 250 = Rs.25,000.

This is in addition to a long position to buy 1000 kilograms in August.

If the option is closed out immediately

Amount receivable = (Rs.402 – Rs.400) x Rs.250 = Rs.500

Entering into Future Options (put option)

A has one August future put option on paddy with a strike price of Rs.400 per quintal. One future contract is on 100 quintals of paddy. Current futures price of corn for delivery in August is Rs.380 per quintal and the most recent settlement price is Rs.370 per quintal.

If the option is exercised, A receives a cash amount of (Rs.400 – Rs.370) x 100 = Rs.30,000. He also gains an additional advantage to hold the short position to sell 100 quintals of paddy in August.

In case, if the option is closed out, A will be having (Rs.380 – 370) x 100 = Rs.10,000 leaving Rs.20,000 as net payoff.

Growth of Derivatives in India – Currently and in the coming years

Interest rate derivatives⁶

(Turnover in crores of Rupees)

<i>Year</i>	<i>Total Contracts</i>	<i>Total Turnover</i>	<i>Total OI - Contracts</i>	<i>Average Daily Turnover</i>	<i>Trading Days</i>
2017-2018**	7,877,984	162,519	4,899,692	671.57	242
2017-2018*	1,969,496	40,630	1,224,923	688.64	59
2016-2017	6,185,341	127,980	2,090,108	528.84	242
2015-2016	5,687,653	114,121	8,887,324	471.57	242
2014-2015	2,033,275	41,913	9,684,124	176.1	238
2013-2014	128,549	2,580	73,814	62.93	41

Source: www.bse.com

* Upto 30th June 2017.

** Annualised on the basis of data for the first quarter of 2017-2018.

Currency derivative⁶

Year	Total Contracts	Total Turnover	Premium Turnover	Open Interest (No of contracts)	Avg . Daily Turn over	Avg. Daily Pre-mium Turn-over	No. of Trading Days
2017-18 **	657,029,404	4,260,331	1,595,800	3,687,276	18,052	6,762	236
2017-18 *	164,257,351	1,065,083	398,950	921,819	18,052	6,762	59
2016-17	470,425,202	317,164,794	1,810,725	1,598,346	1,310,598	7,482	242
2015-16	420,226,542	2,763,926	1,142,692	1,287,841	11,421	4,722	242
2014-15	309,176,043	1,908,543	-	664,668	8,019	-	238
2013-14	39,157,195	244,312	-	41,532	3,016	-	81

* Upto 30th June 2017.

** Annualised on the basis of data for the first quarter of 2017-2018.

Options⁶**Index options**

Year	Call Contracts	Call Turnover	Call Premium Turnover	Put Contracts	Put Turnover	Trading Days
2017-18	82	5.92	0.03	32	2.29	61
2016-17	24,433	1,254.90	13.35	63,916	3,214.45	248
2015-16	5,87,73,325	25,60,540.69	385.49	4,46,54,651	18,25,708.19	247
2014-15	24,42,03,156	1,01,12,605.13	-	25,40,31,531	1,00,16,621.34	243
2013-14	18,26,85,008	57,05,316.57	-	11,36,74,567	33,49,884.04	251
2012-13	11,63,24,195	32,30,232.06	-	14,09,09,766	37,97,249.53	250
2011-12	72,06,514	2,00,089.57	-	1,75,69,130	4,18,252.79	249
2010-11	-	-	-	10	0.25	255
2009-10	5,276	137.76	-	-	-	244
2008-09	251	6.11	-	122	3.01	243
2007-08	951	31	-	210	7.66	251
2006-07	2	0.06	-	-	-	249
2005-06	100	3.2	-	-	-	251
2004-05	48,065	1,470.61	-	27,210	826.62	253
2003-04	-	-	-	-	-	254

Equity Options

<i>Year</i>	<i>Put Premium Turnover</i>	<i>Call Contracts</i>	<i>Call Turnover</i>	<i>Call Premium</i>	<i>Put Contracts Turnover</i>	<i>Put Turn over</i>	<i>Put Premium Turn over</i>
2017-18	-	-	-	-	-	-	-
2016-17	20.02	-	-	-	-	-	-
2015-16	274.34	10,09,439	31,904.16	374.25	14,13,452	42,408.53	351.32
2014-15	-	30,10,092	93,854.50	-	27,00,450	81,233.84	-
2013-14	-	6,67,365	22,185.51	-	8,77,355	23,945.18	-
2012-13	-	1,78,313	5,186.57	-	2,09,557	5,059.75	-
2011-12	-	39,848	1,277.27	-	7,657	191.82	-
2010-11	-	-	-	-	-	-	-
2009-10	-	-	-	-	-	-	-
2008-09	-	-	-	-	-	-	-
2007-08	-	9	0.21	-	6	0.14	-
2006-07	-	5	0.16	-	1	0.04	-
2005-06	-	2	0.09	-	-	-	-
2004-05	-	72	2.08	-	17	0.5	-
2003-04	-	3,466	139.07	-	2,544	119.77	-

Futures⁶

<i>Year</i>	<i>Index Futures</i>			<i>Equity Futures</i>			
	<i>Contracts</i>	<i>Turnover</i>	<i>Premium Turnover</i>	<i>Contracts</i>	<i>Turnover</i>	<i>Premium Turnover</i>	<i>Trading Days</i>
2017-18	39,676	2,878.74	2,878.74	163	13.14	13.14	61
2016-17	32,288	2,266.86	2,266.86	2,901	203.08	203.08	248
2015-16	3,06,712	13,097.16	4,230.90	51,815	1,349.59	245.52	247
2014-15	12,27,926	48,632.35	-	3,05,714	9,794.26	-	243
2013-14	21,36,269	63,493.84	-	19,01,877	54,599.42	-	251
2012-13	47,01,927	1,22,429.78	-	1,16,933	3,420.07	-	250
2011-12	70,73,334	1,78,448.83	-	3,26,342	10,215.70	-	249
2010-11	5,613	154.08	-	-	-	-	255
2009-10	3,744	96	-	8	0.3	-	244
2008-09	4,95,830	11,757.22	-	299	8.49	-	243
2007-08	71,57,078	2,34,660.16	-	2,95,117	7,609.24	-	251
2006-07	16,38,779	55,490.86	-	1,42,433	3,515.50	-	249
2005-06	89	5	-	12	0.49	-	251
2004-05	4,49,630	13,599.66	-	6,725	212.85	-	253
2003-04	1,03,777	3,082.63	-	33,437	1,680.34	-	254

From the above tables, we can visualize that in India both Interest rate derivative and Currency derivative shows an increasing trend and are anticipated to grow in leaps and bounds.

Index Options has shown an decreasing trend and Equity options is in the process of growing.

Futures – both index and equity futures have shown an increase until 2012-2013 and thereafter have shown an decreasing trend.

Pitfalls of Derivatives

Derivatives are very versatile instruments and are used for hedging, for speculation, and for arbitrage. It is this very phenomenon that at many times becomes the potential root cause of many financial issues. Many a times, traders who have the obligation to hedge risks took to speculation.

Business snapshot⁴

Jerome Kerviel joined Soci te  Ge n rale (SocGen) in 2000 to work in the compliance area. In 2005, he was promoted and became a junior trader in the bank's Delta One products team. He traded equity indices such as the German DAX index, the French CAC 40, and the Euro Stoxx 50. His job was to look for arbitrage opportunities. These might arise if a futures contract on an equity index was trading for a different price on two different exchanges. They might also arise if equity index futures prices were not consistent with the prices of the shares constituting the index. Kerviel used his knowledge of the bank's procedures to speculate while giving the appearance of arbitraging. He took big positions in equity indices and created fictitious trades to make it appear that he was hedged. In reality, he had large bets on the direction in which the indices would move. The size of his unhedged position grew over time to tens of billions of euros. In January 2008, his unauthorized trading was uncovered by SocGen. Over a three day period, the bank unwound his position for a loss of 4.9 billion euros. This was at the time the biggest loss created by fraudulent activity in the history of finance. Rogue trader losses were not unknown at banks prior to 2008.

For example, in the 1990s, Nick Leeson, who worked at Barings Bank, had a mandate similar to that of Jerome Kerviel. His job was to arbitrage between Nikkei 225 futures quotes in Singapore and Osaka. Instead he found a way to make big bets on the direction of the Nikkei 225 using futures and options, losing \$1 billion and destroying the 200-year old bank in the process.

In 2002, it was found that John Rusnak at Allied Irish Bank had lost \$700 million from unauthorized foreign exchange trading.

Thus it is evident that it is not only important to define unambiguous risk limits for traders but also to monitor that the limits are strictly adhered to.

Regulatory environment

As mentioned supra, L C Gupta Committee Report forms the basis of the modern derivative markets in India.

Regulatory environment broadly stresses on three aspects:

- (1) Investor protection

- (2) Market efficiency
- (3) Market integrity
- (4) Financial Integrity.

To achieve these objectives, the L.C. Gupta Committee Report recommended the following:

- (1) Division of regulatory responsibility between the exchange and the SEBI.
- (2) SEBI's role should be restricted to approving rules, bye laws and regulations of a derivatives exchange as also to approving the proposed derivatives contracts before commencement of their trading.
- (3) Emphasis on the supervisory and advisory role of SEBI with a view to permitting desirable flexibility, maximizing regulatory effectiveness and minimizing regulatory cost.
- (4) Regulatory requirements for authorization of derivatives brokers/dealers include relating to capital adequacy, net worth, certification requirement and initial registration with SEBI.
- (5) Establishment of a separate clearing corporation, maximum exposure limits, mark to market margins, margin collection from clients and segregation of clients' funds, regulation of sales practice and accounting and disclosure requirements for derivatives trading.
- (6) Methodology for risk containment measures for index-based futures and options, stock options and single stock futures.
- (7) Calculation of margins, position limits, exposure limits and reporting and disclosure.

Conclusion

Derivatives have been the most innovative and exciting discovery in the Capital Market since the past few decades. Both hedgers and speculators find it more attractive to trade a derivative on an asset than to trade the assets itself. Three main types of traders can be identified: hedgers, speculators, and arbitrageurs.

Acknowledgements

- 1 Options, Futures and Other Derivatives – John C Hull – Eighth Edition.
- 2 Accounting Standard – 30 issued by the Institute of Chartered Accountants of India
- 3 Accounting Standard – 31 issued by the Institute of Chartered Accountants of India
- 4 Options, Futures and Other Derivatives – John C Hull – Eighth Edition.
- 5 Illustrations adapted from Options, Futures and Other Derivatives – John C Hull – Eighth Edition.
- 6 www.bse.com

Emerging Financial Products – Harnessing Opportunities

CS Anu Amodia*

1. Capital Market

1.1 *Introduction* : In the last two decades, studies on the capital market have received considerable attention from contemporary finance and economics literature resulting from its role in the provision of long-term, non-debt financial capital which enables companies to avoid over-reliance on debt financing, thus improving corporate debt-to-equity ratio and also in the mobilization of resources for national growth. The capital market is viewed as a complex institution imbued with inherent mechanism through which long-term funds of the major sectors of the economy comprising households, firms, and government are mobilized, harnessed and made available to various sectors of the economy. For sustainable economic growth, funds must be effectively mobilized and allocated to enable businesses and the economies harness their human, material, and management resources for optimal output. Hence, the capital market is an economic institution, which promotes efficiency in capital formation and allocation.

The capital market contributes to economic growth through the specific services it performs either directly or indirectly. Notable among the functions of the capital market are mobilization of savings, creation of liquidity, risk diversification, improved dissemination and acquisition of information and enhanced incentive for corporate control. Improving the efficiency and effectiveness of these functions, through prompt delivery of their services can augment the rate of economic growth.



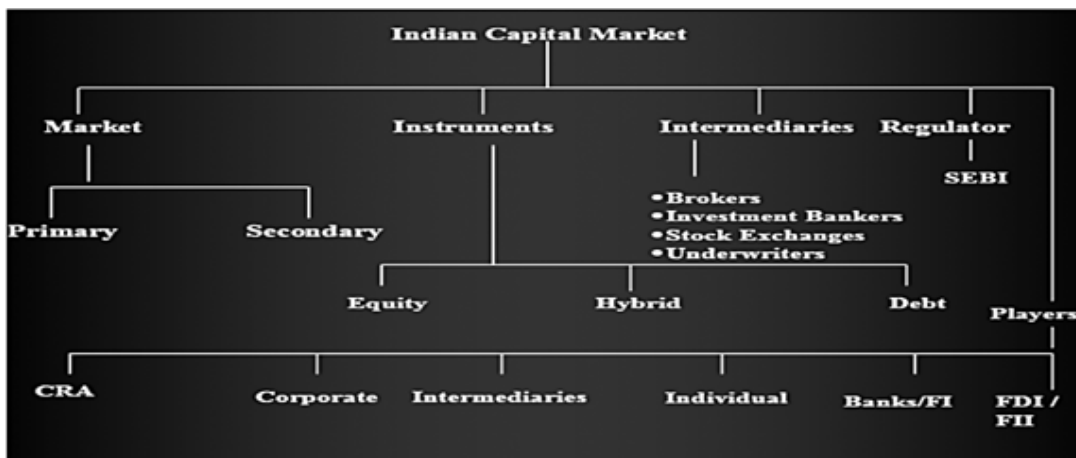
In recent times there has been a growing concern on the role of capital market in economic growth and thus the capital market has been the focus of economic policies and policy makers because of the perceived benefits it provides for the economy. The capital market provides the fulcrum for stock market activities and it is often cited as a barometer of business direction. An active capital market may be

* M.Com., PGDBA, ACS. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

relied upon to measure changes in the general level of economic activities.

Deducing from the extensive studies on the theoretical expectations on the role of capital markets on economic growth which have formed the core of normative economics, the capital market is expected to contribute to economic growth through the transmission mechanisms of savings mobilization, creation of liquidity, risk diversification, improved dissemination and acquisition of information, provision of long-term, non-debt financial capital which enables companies to avoid over-reliance on debt financing, and enhanced incentive for corporate control amongst others.

- 1.2 *Definition* : Capital market is a market where buyers and sellers engage in trade of financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Modern capital markets are almost invariably hosted on computer-based electronic trading systems; most can be accessed only by entities within the financial sector or the treasury departments of governments and corporations, but some can be accessed directly by the public. There are many thousands of such systems, most serving only small parts of the overall capital markets. Entities hosting the systems include stock exchanges, investment banks, and government departments.
- 1.3 *Description*: Capital markets help channelise surplus funds from savers to institutions which then invest them into productive use. Generally, this market trades mostly in long-term securities.



A capital market can be either a primary market or a secondary market. In primary markets, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments issue only bonds, whereas companies often issue either equity or bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary markets, existing securities are sold and bought among investors or traders, usually

on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the willingness of investors in primary markets, as they know they are likely to be able to swiftly cash out their investments if the need arises.

A second important division falls between the stock markets (for equity securities, also known as shares, where investors acquire ownership of companies) and the bond markets (where investors become creditors).

2. Equity & Debt

2.1 *Introduction* : Equity capital is based on the value of the business and its current assets, essentially selling the right to a particular asset, or portion of an asset, in return for capital. Debt capital is raised through the acquisition of new debt obligations. While the current value of a company and other pertinent financial information may be required as part of the application process, the funding is not provided in exchange for owning a portion of an asset. In Bombay Stock Exchange (BSE), which is the oldest stock exchange in the country, for equity there are 7832 companies listed as on date (July 2017). The BSE has a record of being the only with highest number of listed companies in the world. Out of it, 4331 Companies are Active, 1301 Companies are Suspended due to penal reason and 2207 Companies are delisted. For Debentures and Bonds, there are 15740 Companies listed out of which 7376 Companies are Active, 519 companies are Suspended due to penal reason and 7845 Companies are delisted.

2.2 *Equity* : No matter how many financial instruments you pick, none of them can match the returns provided by equity related instruments such as Stocks and Mutual Funds. While investing in these instruments, make sure that you pick products for the long term i.e at least 10 years or more and your emotions are under control in this period.



This doesn't mean you have to stick to the product even though it is not performing well. Review the products every year or switch to better products only if something has gone wrong fundamentally. Mutual funds also give you an option of monthly SIP, where you can invest in a disciplined manner for your retirement. Equity related products are also tax free after 1 year of investment.

2.3 *Debt* : In the recent past, the corporate debt market has seen a high growth of innovative asset-backed securities. The servicing of debt and related obligations for such instruments is backed by some sort of financial assets and/or credit support from a third party. Over the years greater innovation has been witnessed in the corporate bond issuances, like floating rate instruments, zero coupon bonds, convertible bonds, callable (put-able) bonds and step-redemption bonds. These innovative issues have provided a gamut of securities that caters to a wider segment of investors in terms of maintaining a desirable risk-return balance. Over the last five years, corporate issuers have shown a distinct preference for private placements over public issues. This has further cramped the liquidity in the market. The dominance of private placement in total issuances is attributable to a number of factors. Lengthy issuance procedure for public issues, in particular, the information disclosure requirements. Costs of a public issue are considerably higher than those for a private placement. The quantum of

money raised through private placements is typically larger than those that can be garnered through a public issue. Also, a corporate can expect to raise debt from the market at finer rates than the prime-lending rate of banks and financial institutions only with an AAA rated paper. This limits the number of entities that would find it profitable to enter the market directly.

2.4 *The Indian capital market - Growth with governance*: Importance of the development of the corporate debt market. The economic advantages of having a viable private DCM can be grouped into three broad categories - (a) Diversification: It gives providers of capital access to a broader set of diversification opportunities. In India today, household wealth is parked in bank deposits, real estate and gold, with very limited stock ownership. More active insurance and pension markets, for example, would allow families to spread investment risks more broadly. In turn, these institutional investors would contribute to enhancing credit price disclosure as they allocate resources into interest-bearing securities. (b) Efficiency in managing cost of capital: Access to a functioning DCM, and the multiple financing options that come with it, endows borrowers with greater efficiency in managing the cost of capital. Historical and cross-sectional experience teaches that problems in the banking sector can interrupt the flow of funds from savers to investors for a dangerously long period of time. Indeed, one of the lessons from the 1997 Asian financial crisis has been the importance of having non-bank funding channels open. In the wake of this crisis, a number of countries in the region, including Korea, Malaysia, Singapore and Hong Kong, have made progress in building their own corporate debt markets. (c) Financial stability: On-the-ground estimates indicate that the total stock of non-equity claims on India's corporate sector could be somewhere in the region of 10% of GDP. With listed securities worth just USD 21 billion, this means that roughly 80% of the market is in the form of private placements. These liabilities are negotiated and priced on the principles of relationship lending, issued with virtually no public disclosure, and are typically held to maturity by banks. This brings us to a third set of reasons why developing a debt capital market is in India's interest. The current system of financing has already, and will increasingly, become less adequate for an economy as large and as ambitious as India's. Spreading credit risk from banks balance sheets more broadly through the financial system would lower the risks to financial stability. And a deeper, more responsive interest rate market would allow the central bank greater degrees of freedom in the conduct of monetary policy. This will be particularly important as India gradually opens up its capital markets to the rest of the world.

2.5 *Debt vs. Equity* : Debt is one of the two main ways companies can raise capital in the capital markets. Companies like to issue debt because of the tax advantages. Interest payments are tax-deductible. Debt also allows a company or business to retain ownership, unlike equity. Additionally, in times of low interest rates, debt is abundant and easy to access.

Equity is more expensive than debt, especially when interest rates are low. However, unlike debt, equity does not need to be paid back if earnings decline. On the other hand, equity represents a claim on the future earnings of the company as a part owner.

3. Financial Sector and its Products

3.1 *Introduction* : India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market. The sector comprises commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. The banking regulator has allowed new entities such as payments banks to be created recently thereby adding to the types of entities operating in the sector. However, the financial sector in India is predominantly a banking sector with commercial banks accounting for more than 64 per cent of the total assets held by the financial system.



Financial products refer to instruments that help you save, invest, get insurance or get a mortgage. These are issued by various banks, financial institutions, stock brokerages, insurance providers, credit card agencies and government sponsored entities. Financial products are categorised in terms of their type or underlying asset class, volatility, risk and return.

The Government of India has introduced several reforms to liberalise, regulate and enhance this industry. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance for Micro, Small and Medium Enterprises (MSMEs). These measures include launching Credit Guarantee Fund Scheme for Micro and Small Enterprises, issuing guideline to banks regarding collateral requirements and setting up a Micro Units Development and Refinance Agency (MUDRA). With a combined push by both government and private sector, India is undoubtedly one of the world's most vibrant capital markets.

3.2 *New India's Government Initiatives*

- In the Union Budget 2017-18, the Government of India has announced a few key reforms like abolishment of Foreign Investment Promotion Board in 2017-18, Introduce bill for curbing illicit deposit schemes, Establish a Computer Emergency Response Team for financial sector (CERT-Fin) and set aside Rs 10,000 crore (US\$ 1.5 billion) towards recapitalisation of banks.
- SEBI plans to tighten the norms governing various market participants in order to strengthen scrutiny, improve transparency and mitigate liquidity risks from algorithmic trading.
- SEBI has relaxed norms for registered foreign portfolio investors (FPIs) in India, allowing them to operate through the International Financial Services Centre (IFSC) without undergoing any additional documentation or prior approval process.
- The RBI has introduced trading in interest rate options (IRO), effective from January 31, 2017, which will provide another avenue to market participants to hedge and speculate on interest rate risk.

- SEBI plans to allow investors to make mutual funds transactions worth up to Rs 50,000 (US\$ 750) a month through digital wallets, as part of its efforts to digitise the distribution processes for all financial products. It also plans to allow immediate credit to customer's bank accounts on liquid mutual funds redemption to attract retail customers as well as boost inflows.
- Mr Ravi Shankar Prasad, Union Minister of Law & Justice and Information Technology, has launched a free Doordarshan DTH channel called DigiShala, which will help people understand the use of unified payments interface (UPI), USSD, aadhaar-enabled payments system, electronic wallets, debit and credit cards, thereby promoting various modes of digital payments.
- The Government of India has relaxed norms for small merchants with a turnover of up to Rs. 2 crore (US\$ 300,000), allowing them to pay 6 per cent of deemed profit in tax instead of 8 per cent of total turnover or gross receipts received through banking channels or digital means for FY 2016-17, in a bid to encourage cashless transactions in the country.
- The Prime Minister of India has launched the Micro Unit Development and Refinance Agency (MUDRA) to fund and promote Microfinance Institutions (MFIs), which would in turn provide loans to small and vulnerable sections of the business community. The lending target has been fixed at Rs. 244,000 crore (US\$ 36.46 billion) for 2017-18.
- Government of India's 'Jan Dhan' initiative for financial inclusion is gaining momentum. Under Pradhan Mantri Jan Dhan Yojna (PMJDY), 217 million accounts have been opened and 174.6 million RuPay debit cards have been issued. Government of India aims to extend insurance, pension and credit facilities to those excluded from these benefits under the Pradhan Mantri Jan Dhan Yojana (PMJDY). The Union Cabinet Minister has also approved the Pradhan Mantri Suraksha Bima Yojana which will provide affordable personal accident and life cover to a vast population.
- The Department of Industrial Policy and Promotion (DIPP) has allowed 100 per cent Foreign Direct Investment (FDI) in asset reconstruction companies (ARC) under automatic route, which will help to tackle the issue of declining asset quality of banks.

4. **Emerging Financial Products - Harnessing Opportunities (Municipal Bonds, Reit's, Invit's etc.)**

4.1 'Municipal Bond'

4.1.1



Definition : A municipal bond is a debt security issued by a state, municipality or county to finance its capital expenditures, including the construction of highways, bridges or schools. Municipal bonds are exempt from federal taxes and from most state and local taxes, making them especially attractive to people in high income tax brackets.

4.1.2 *Types of Municipal Bonds*

Municipal bonds are generally issued as one of three types of debt obligation:

- General Obligation (GO) Bonds repay based on the “full faith and credit of the issuer” and are considered the most secure type of bond, carrying the lowest interest rate.
- Revenue Bonds repay from a specified future stream of income, such as a utility or payments from customers or tenants.
- Assessment Bonds obligate repayment from property tax assessment within the municipality.

Returns vary considerably between municipalities, which makes research an essential part of municipal bond investing. However, municipal bond ETFs and mutual funds will do a portion of this research for you and can be a lifesaver for investors with busy schedules.

4.1.3 *Tax status of Municipal Bonds*

Municipal bonds in India have tax-free status if they conform to certain rules and their interest rates will be market-linked. Both public issue and private issue can be adopted for municipal bonds. SEBI allowed urban local bodies to raise money through the issue of revenue bonds as well. Municipal bonds where the funds raised are kept for one project are termed revenue bonds. Servicing of these bonds can be made from revenue accrued from the project.

4.1.4 *Pros & Cons to Municipal Bond Investing*

An examination of the pros and cons relative to your financial situation and goals will help you determine whether investing in municipal bonds is likely to be profitable or not.

Advantages

1. *Free from federal taxes* : No one likes handing over a chunk of cash to the tax man. If you are in a high tax bracket or are seeking to create a tax exempt income stream for retirement, municipal bonds might be just the thing to supplement your traditional pension, Roth IRA, or 401k investments. This tax refuge offers liquidity and tax efficiency all in one, a godsend to those in the highest tax brackets.
2. *Free from state and local taxes* : Municipal bonds are not only exempt from federal taxes, but if you play your cards right, you might dodge state and local taxes as well. In most states, investments in local municipal development projects are exempted from state and local taxes in addition to federal taxes.
3. *Tax advantaged compound growth and/or income* : Sheltering your investment accounts from taxes allows growth to compound more quickly than in a taxable account. Municipal bonds purchased through a mutual fund or ETF allow you to reinvest bond income which results in compound growth.
4. *Lower volatility than stocks (fixed income assets)* : If the volatility of the stock market leaves your stomach churning, you may want to switch to an asset class with

somewhat lower volatility. Municipal bonds historically have been one of the safest places to park your savings (short of a savings account or Treasury bonds), while also providing tax exempt returns and a generally much better return on invested capital than either FDIC insured accounts or Treasuries.

5. *High level of liquidity* : Municipal bonds are highly liquid and are traded on a secondary market. This means that if you are strapped for cash or need an influx of money for an investment opportunity or emergency, the capital can be accessed quickly and without incurring a tax penalty. This is especially true for investors who invest via ETFs or mutual funds.

Disadvantages

1. *Bond yields may not beat inflation* : If you're not investing in municipal bonds for current income, but instead for long-term tax-advantaged growth, you'll want to consider how your bond investment will hold up to inflation. Because municipal bonds are often a conservative investment and they also offer tax advantages, their yields tend to be relatively low. Therefore, they are less likely to beat inflation than many other investments, such as stocks. This means the money you have parked in a bond fund could be worth less in buying power a few years from now than it is today.
2. *Opportunity cost* : If you decide to invest in municipal bonds, take a good look at the equation above or visit one of the many online calculators that will calculate your taxable equivalent yield. Running this calculation is essential to ensure that municipal bonds make more sense for you than a taxable bond investment. If you are in a low tax bracket, for example, you won't be able to capitalize on the tax advantages of a municipal bond as much as someone in a high tax bracket. Moreover, you may give up the opportunity to realize the higher return on a comparable taxable bond if you invest in a municipal bond instead.
3. *Interest rate risk* : When interest rates go up, current bonds lose value. This is because bonds that carry a lower interest rate must be sold at a discount to equal current bond yields. This is less of a concern if you plan to hold the bonds to maturity, but it can still be a difficult pill to swallow if you have to cash out bonds or bond funds when they are trading at less than face value.
4. *Risk of default and loss of capital* : Any investment carries risk. Municipal bonds are no different. Although historically, it's been rare, there's always the chance the municipality could go belly up, in which case your interest payments and principal would be lost.

4.1.5 How to Invest in Municipal Bonds :



Generally speaking, there are two ways to invest in municipal bonds: directly or through a municipal bond fund. Investors can purchase bonds directly from a municipality through their bank or broker. This method offers investors the comfort of knowing precisely what bonds they own within their portfolio, such as general

obligation, revenue, or assessment bonds, as well as the exact term and yield offered by the investment.

The second way to invest in municipal bonds is to purchase shares in a municipal bond fund. This method offers instant diversification across hundreds of municipal bonds, which can reduce risk for investors. Another significant advantage is the increased liquidity available via bond funds. Fund shares can be sold at any time, so investors will have no problem unloading their bonds for any reason.

4.1.6 *Final word*

Municipal bonds offer investors a number of advantages in the never-ending quest to minimize taxes and grow capital. Before you rush into the municipal bond market, however, make sure to do your homework. No investment is perfect and municipal bonds may not be the best investment to diversify your portfolio, especially if you are in a low tax bracket.

That said, if you are in a high tax bracket and looking for a relatively conservative investment to provide tax-advantaged growth or income, complementing your portfolio with municipal bonds may be an attractive solution.

4.2 *'Real Estate Investment Trust - REIT'*

4.2.1 **Definition:** A REIT is a type of security that invests in real estate through property or mortgages and often trades on major exchanges like a stock. REITs provide investors with an extremely liquid stake in real estate. They receive special tax considerations and typically offer high dividend yields.

4.2.2 **Description :** REITs, an investment vehicle for real estate that is comparable to a mutual fund, allowing both small and large investors to acquire ownership in real estate ventures, own and in some cases operate commercial properties such as apartment complexes, hospitals, office buildings, timber land, warehouses, hotels and shopping malls.

All REITs must have at least 100 shareholders, no five of whom can hold more than 50% of shares between them. At least 75% of a REIT's assets must be invested in real estate, cash or U.S. Treasuries; 75% of gross income must be derived from real estate.

REITs are required by law to maintain dividend payout ratios of at least 90%, making them a favorite for income-seeking investors. REITs can deduct these dividends and avoid most or all tax liabilities, though investors still pay income tax on the payouts they receive. Many REITs have dividend

reinvestment plans (DRIPs), allowing returns to compound over time.



As of August 2014, India approved creation of real estate investment trusts in the country. Indian REITs (country specific/generic version I-REITs) will help individual investors enjoy the benefits of owning an interest in the securitised real estate market. The greatest benefit will be that of fast and easy liquidation of investments in the real estate market unlike the traditional way of disposing of real estate. The Government and Securities and Exchange Board of India through various notifications is in the process of making it easier to invest in real estate in India directly and indirectly through foreign direct investment, through listed real estate companies and mutual funds. In the budget of 2014, Finance Minister Arun Jaitley has introduced a law for setting up of REITs.

A REIT will need to be registered via an IPO or initial public offering. REIT units, as such, will have to get listed with exchanges and consequently traded as securities. The SEBI board has kept the minimum asset sizes to be invested in at Rs 500 crore. However, the minimum issue size would have to be less than Rs 250 crore. As with stocks, the investors here would be able to buy the units from either primary and/or the secondary markets.

4.2.3 *How does a REIT work?*

REIT is a process to generate funds from a lot of investors to directly invest in profitable real estate properties like offices, residential units, hotels, shopping centers, warehouses and more. All trusts with REIT will be listed with stock exchanges as they would be structured like trusts. Consequently, REIT assets will be held with independent trustees for unit holders / investors.

4.2.4 *Role of the trustees* : Trustees with REIT have defined duties which typically involve ensuring compliance and adherence to all applicable laws that protect the rights of the investors.

4.2.5 *The objective of REITs* : A REIT's objective is to provide the investors with dividends that are generated from the capital gains accruing from the sale of the commercial assets. The trust distributes 90% of the income among its investors via dividends. Apart from minimum entry level, a REIT is supposed to provide diversified and safe investment opportunities with reduced risks and under a professional management to ensure the maximum return on investments.

4.2.6 The advantages with REITs include:

- *Income dividends* : 90% of distributable cash at least twice in a year
- *Transparency* : REIT will showcase the full valuation on a yearly basis and will also update it on a half-yearly basis
- *Diversification* : According to the guidelines, REITs will have to invest in a minimum of two projects with 60% asset value in a single project
- *Lower risk* : At least 80% of the assets will have to be invested into revenue-generating and completed projects. The remaining 20% of the properties that include properties like under construction projects, equity shares of the listed properties, mortgage- based securities, equity shares that derive a minimum of

75% of income from Government securities or G-secs, money market instruments, cash equivalents and real estate activities.

The REIT concept has been in the news for some time now. However, the real estate regulations rolled out so far have not quite helped bring them to Ground Zero in India as yet. REITs' exemption from tax on the distribution of dividends would make it much more attractive for investors. According to a recent report by Cushman & Wakefield, commercial properties in India that are 'REITable' investment opportunities are between \$43 billion and \$54 billion across the top cities.

4.2.7 To qualify as a REIT a company must

- Invest at least 75 percent of its total assets in real estate
- Derive at least 75 percent of its gross income from rents from real property, interest on mortgages financing real property or from sales of real estate
- Pay at least 90 percent of its taxable income in the form of shareholder dividends each year
- Be an entity that is taxable as a corporation
- Be managed by a board of directors or trustees
- Have a minimum of 100 shareholders
- Have no more than 50 percent of its shares held by five or fewer individuals

4.2.8 Are REITs more attractive than actual property purchase?

Investing in REIT can be compared to investing in Gold Bonds. Indians are partial to buying physical gold rather than in Gold Bonds, implying that having one's own investment in property will always provide Indians greater satisfaction than mere paper investments. The Indian property market is now almost stabilized and it is the right time to buy self-owned homes. While it is human tendency to wait and watch, the bottom of the market cannot be fathomed accurately at the best of times.

At the end of the day, REITs are investment instruments and not a means to acquire actual property – which is always high on every Indian's wish-list. A budget that clearly favours purchase decisions for first- time home buyers and is a step closer to the Prime Minister's mission to provide Housing for all by 2022 is in place. 2017 is certainly the year to make home ownership a reality.

4.3 'Infrastructure Investment Trusts (InvIT'S) '

- 4.3.1 *Definition* : An Infrastructure Investment Trust (InvITs) is like a mutual fund, which enables direct investment of small amounts of money from possible individual/institutional investors in infrastructure to earn a small portion of the income as return. InvITs work like mutual funds or real estate investment trusts (REITs) in features. InvITs can be treated as the modified version of REITs designed to suit the specific circumstances of the infrastructure sector.



- 4.3.2 *Description* : SEBI notified the SEBI (Infrastructure Investment Trusts) Regulations, 2014 on September 26, 2014, providing for registration and regulation of InvITs in India. The objective of InvITs is to facilitate investment in the infrastructure sector.

InvITs are like mutual funds in structure. InvITs can be established as a trust and registered with Sebi. An InvIT consists of four elements: 1) Trustee, 2) Sponsor(s), 3) Investment Manager and 4) Project Manager.

The trustee, who inspects the performance of an InvIT is certified by SEBI and he cannot be an associate of the sponsor or manager.

'Sponsors' are people who promote and refer to any organisation or a corporate entity with a capital of Rs 100 crore, which establishes the InvIT and is designated as such at the time of the application made to SEBI, and in case of PPP projects, base developer.

Promoters/sponsor(s), jointly, have to hold a minimum of 25 per cent for three years (at least) in the InvIT, excluding the situations where an administrative requirement or concession agreement needs the sponsor to hold some minimum percent in the special purpose vehicle. In these cases, the total value of the sponsor holding in the primary special purpose vehicle and in the InvIT should not be less than 25 per cent of the value of units of InvIT on post-issue basis.

Investment manager is an entity or limited liability partnership (LLP) or organisation that supervises assets and investments of the InvIT and guarantees activities of the InvIT. Project manager refers to the person who acts as the project manager and whose duty is to attain the execution of the project and in case of PPP projects. It indicates that the entity is responsible for such execution and accomplishment of project landmark with respect to the agreement or other relevant project document.

- 4.3.3 *Features* : InvITs have to ensure that they distribute 90% of their net cash flows to the unit investors. There is a leverage cap of 49% on the net asset value. There is also a cap on exposure to under-construction assets (for publicly placed InvITs). The sponsor of the InvIT is responsible for setting up the InvIT and appointing the trustee. The sponsor shall hold minimum 15% of the units issued by the InvIT with a lock-in period of three years from the date of issuance of units. The InvIT regulations also require companies to maintain certain investment ratios, including 80 percent of investments in completed and revenue-generating assets.

InvITs that have been filed so far have specified minimum investment limits of Rs 10 lakh per investor.

- 4.3.4 *When are distributions given out?*

InvITs distribute regular dividends. They must be declared and distributed not less than once in every six months. The amount of cash available for distribution depends upon the InvIT's own dividend or interest income and principal payments from its portfolio. All Non-Resident Investors including eligible NRIs should note that refunds, dividends and other distributions, if any, will be payable in Indian Rupees only.

- 4.3.5 *Global experience* : Worldwide InvITs are positioned as high-dividend paying

investments suitable for investors who are especially looking for long-term, stable cash flows with moderate capital appreciation.

- 4.3.6 *Taxation* : Investors of InvITs can draw comfort from a favorable tax-regime. Dividend income is tax exempt and no capital gains are levied if units are held for over 3 years and sold through the bourses. There is a small withholding tax for interest income to NRI unit holders. Further, there is the pass-through structure of InvITs mandating distribution of a minimum 90% of net-distributable cash and nil dividend distribution tax.
- 4.3.7 *Delisting* : The InvIT Regulations provide for delisting of units from the stock exchanges in accordance with the InvIT Regulations.
- 4.3.8 *Road Ahead* : The investment mechanism facilitates capital into the infrastructure sector by pooling small sums of money from investors, helping infrastructure developers monetise their infrastructure assets and complete projects that sometimes get stalled midway due to lack of funding.

InvITs issue units to investors against underlying revenue-generating infrastructure assets which have received commercial operation date (COD) and have been generating revenues since at least for a year. This gives unit holders a chance to directly invest in the project and, in return, get a portion of the net distributable cash flows.

DISTRIBUTION POLICY	
Distribution policy	<ul style="list-style-type: none"> At least 90% of distributable cash flow of the SPV shall be distributed to the InvIT in proportion to its holding in the SPV. At least 90% of distributable cash flow of the InvIT shall be distributed to the unit holders. Dividend declared to be paid within 15 days; distributions to the unit holders to be made on a half yearly basis.
Leveraging	<ul style="list-style-type: none"> Borrowings and deferred payments not to be more than 49% of value of InvIT assets (excluding any borrowings made by the InvIT to the SPVs). Borrowings and deferred payments more than 25% of the value of assets are subject to: <ul style="list-style-type: none"> Credit rating; Approvals of unit holders where the votes cast in favor should be more than the votes cast against the resolution.
Delisting	<ul style="list-style-type: none"> If public float is less than 25% of total outstanding units. Number of unit holders (other than sponsor) is less than 20 (each holding not more than 25% of units of InvIT). Where no projects / assets are remaining under the InvIT for more than 6 months, and where there is no proposal to invest in projects in future.

The units gets listed on stock exchanges to provide liquidity to unit holders. The InvIT can also fund future development and acquisitions through the issuance of additional units.

While this fund-raising tool can help infra developers deleverage, experts noted it may also and reduce funding pressure on the banking system.

The responsibility of ensuring these improvements vest with all the stakeholders in the financial service industry.

REIT & InvIT is a structured business trust model facilitating entrepreneurs and corporate to monetise their capital locked in assets through issue of units to investors at large. Just like a mutual fund scheme, investors can own units in a REITs and the all income is shared among the investors. Units of a REIT are traded on exchanges and provide an investor with an option to quickly exit. Thus, Capital Market of New India is having the reform agenda for inclusive growth in the emerging financial products which is harnessing opportunity in Municipal Bonds, REIT's, InvIT's etc.

Therefore the need for effective and favourable macroeconomic environment to facilitate economic growth and ensure that channels of capital market induced growth are built around effective systems; and that policy institutions are active in making systemic checks and appropriate policy innovations to ensure capital market led economic growth.

- 7. Recommendations :** In line with issues raised in the policy implications, the recommendation is that the relevant regulatory agencies in the capital market should be focused on enhancing the efficiency and transparency of the market in order to improve investor's confidence. Also, there is need for effective and favourable macroeconomic environment to facilitate the causality from stock market to economic growth. It must be understood that growing economies with significant and consistent impact on living standards of the people are a product of effective social, economic and political institutions and this is a major setback in the Indian environment. Thus there is the need to ensure that the channels of capital market induced growth are built around effective systems and that the policy institutions are actively involved in making systemic checks and appropriate policy innovations to ensure capital market led economic growth.

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New Emerging Capital Market in India (Start ups, ITP, SME etc.)

CS Divesh Goyal*

Present Situation of Startups in India

²While India's startup ecosystem continues to develop at a rapid pace, the exit options for risk capital investors, who have poured in billions of dollars backing home-grown ventures, remain bleak, according to the Economic Survey 2015-16 released by the Government and which was tabled by finance minister Arun Jaitley.

The country has more than 19,000 technology-enabled startups, led by consumer Internet and financial services startups. "Indian startups raised \$3.5 billion in funding in the first half of 2015, and the number of active investors in India increased from 220 in 2014 to 490 in 2015. As of December 2015, eight Indian startups belonged to the 'Unicorn' club (ventures that are valued at \$1 billion and upwards)."

Total funding for Indian venture capital-backed companies topped \$12 billion (Rs 82,500 Crore) across more than 1,220 deals in the past two years, with \$7.3 billion invested in over 880 deals in 2015 alone, according to startup data aggregator Tracxn. However, exits for investors, especially through the initial public offering route, continue to remain sparse, driven down by a combination of choppiness in markets globally, difficult listing rules and, in the case of consumer internet startups, the lack of profitability."It is important that startups, too, see 'exit', which would take the form of these companies being listed, allowing the original private investors to cash in on the initial investment, and plough it back into other similar ventures," as per the government "Right now, it's very hard for investors and startups to list in India, which is why we see so many of them relocate outside the country's borders. Exits through IPOs in India will take at least another 5-7 years," said Avinash Raghava, co-founder of iSpirt, a leading software product think tank.

It, however, also stated that exit valuations are expected to increase. "Exit valuations in India are still low, but are expected to increase as the impact of new SEBI policies on listings comes into effect, and as equity markets in general revive from current low valuations caused by a sense of gloom in the global economy,".

The country's equity bourses have been under pressure, due to sustained foreign fund outflows and selling by retail investors, amid the ongoing turmoil in stock markets and concerns over the global economy.

* Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

In its bid to further simulate the country's startup ecosystem, the government has rolled out a number of ambitious projects - Startup India, Make in India, Digital India and Skill India - as it looks to drive sustainable economic growth and generate large-scale employment in Asia's third-largest economy.

³Top Methods by which Satartups can Raise Funds

1. *BOOTSTRAPPING* your Startup Business

Self-funding, also known as bootstrapping, is an effective way of startup financing, especially when you are just starting your business. First-time entrepreneurs often have trouble getting funding without first showing some traction and a plan for potential success. You can invest from your own savings or can get your family and friends to contribute. This will be easy to rise due to less formalities/compliances, plus less costs of rising. In most situations, family and friends are flexible with the interest rate.

Self-funding or bootstrapping should be considered as a first funding option because of its, when you have your own money, you are tied to business. On a later stage, investors consider this as a good point. But this is suitable only if the initial requirement is small. Some businesses need money right from the day-1 and for such businesses, bootstrapping may not be a good option.

Bootstrapping is also about stretching resources – both financial and otherwise – and improves your business cash flow.

2. *Crowd funding As A Funding Option*

Crowd funding is one of the newer ways of funding a startup that has been gaining lot of popularity lately. It's like taking a loan, pre-order, contribution or investments from more than one person at the same time.

This is how crowd funding works – An entrepreneur will put up a detailed description of his business on a crowd funding platform. He will mention the goals of his business, plans for making a profit, how much funding he needs and for what reasons, etc. and then consumers can read about the business and give money if they like the idea. Those giving money will make online pledges with the promise of pre-buying the product or giving a donation.

Anyone can contribute money toward helping a business that they really believe in.

Why you should consider Crowd funding as a funding option for your business?

The best thing about crowd funding is that it can also generate interest and hence helps in marketing the product alongside financing. It is also a boon if you are not sure if there will be any demand for the product you are working on. This process can cut out professional investors and brokers by putting funding in the hands of common people. It also might attract venture-capital investment down the line if a company has a particularly successful campaign.

Also keep in mind that crowd funding is a competitive place to earn funding, so unless your business is absolutely rock solid and can gain the attention of the average

consumers through just a description and some images online, you may not find crowd funding to work for you in the end.

3. *Angel Investment in Startup*

Angel investors are individuals with surplus cash and a keen interest to invest in upcoming startups. They also work in groups of networks to collectively screen the proposals before investing. They can also offer mentoring or advice alongside capital.

Angel investors have helped to start up many prominent companies, including Google, Yahoo and Alibaba. This alternative form of investing generally occurs in a company's early stages of growth, with investors expecting a upto 30% equity. They prefer to take more risks in investment for higher returns.

4. *Venture Capital for Business*

This is where you make the big bets. Venture capitals are professionally managed funds who invest in companies that have huge potential. They usually invest in a business against equity and exit when there is an IPO or an acquisition. VCs provide expertise, mentorship and acts as a litmus test of where the organization is going, evaluating the business from the sustainability and scalability point of view.

A venture capital investment may be appropriate for small businesses that are beyond the startup phase and already generating revenues. Fast-growth companies like Flipkart, Uber, etc with an exit strategy already in place can gain up to tens of millions of dollars that can be used to invest, network and grow their company quickly.

However, there are a few downsides to Venture Capitalists as a funding option. VCs have a short leash when it comes to company loyalty and often look to recover their investment within a three- to five-year time window. If you have a product that is taking longer than that to get to market, then venture-capital investors may not be very interested in you.

5. *Funding from Business Incubators & Accelerators*

Early stage businesses can consider Incubator and Accelerator programs as a funding option. Found in almost every major city, these programs assist hundreds of startup businesses every year.

Though used interchangeably, there are few fundamental differences between the two terms. Incubators are like a parent to a child, who nurtures the business providing shelter tools and training and network to a business. Accelerators so more or less the same thing, but an incubator helps/assists/nurtures a business to walk, while accelerator helps to run/take a giant leap.

6. *Funds by Winning Contests*

An increase in the number of contests has tremendously helped to maximize the opportunities for fund raising. It encourages entrepreneurs with business ideas to set up their own businesses. In such competitions, you either have to build a product or prepare a business plan.

7. *Money through Bank Loans*

Normally, a bank is the first place that entrepreneurs go when thinking about funding. The bank provides two kinds of financing for businesses. One is working capital loan, and other is funding. Working Capital loan is the loan required to run one complete cycle of revenue generating operations, and the limit is usually decided by hypothecating stocks and debtors. Funding from bank would involve the usual process of sharing the business plan and the valuation details, along with the project report, based on which the loan is sanctioned.

8. *Business Loans from Microfinance Providers or NBFCs*

What do you do when you can't qualify for a bank loan? There is still an option. Microfinance is basically access of financial services to those who would not have access to conventional banking services. It is increasingly becoming popular for those whose requirements are limited and credit ratings not favored by bank.

9. *Government Programs for Startup Capital:*

The Government of India has launched 1000 Crore startup fund in Union budget 2014-15 to improve startup ecosystem in India. In order to boost innovative product companies, Government has launched 'bank of ideas and innovation' program.

Government backed '**Pradhan Mantri Micro Units Development and Refinance Agency Limited (MUDRA)**' starts with an initial corpus of Rs. 20,000 Crore to extend benefits to around 10 Lakh SMEs. You are supposed to submit your business plan and once approved, the loan gets sanctioned. You get a MUDRA Card, which is like a credit card, which you can use to purchase raw materials, other expenses etc. Shishu, Kishor and Tarun are three categories of loans available under the promising scheme.

Above mentioned are the methods through which a start up can start and survive in India. Growth of the startups in a country like India is a major factor in relation to emergence of Capital Market. Which leads to the development of healthy business competitions, Investment by the small investor, to attract foreign investors? In a simple word we can say startup help to take out the money from savings to investment in the capital market.

SME Overview

⁴Small and Medium Enterprises (SMEs) are the backbone of a nation's economy. Like any other major economy, India too enjoys its fair share of SMEs which constitute bulk of the industrial base, also contributing significantly to the exports and GDP.

SME segment has been a key engine of growth, employment, wealth distribution and effective mobilization of resources (both capital and skills) in India. Statistically, SME segment contributes to 45% of the manufactured output, 40% of exports, and is among the largest generator of employment in the Indian economy. Today, Indian SMEs operate in sectors ranging from traditional to the most modern industries competing with the best-of-the-world. SMEs in new economy sectors like IT, ITES, retailing, education, entertainment, media and the like represent the new and modern face of India. SMEs take a prominent role in social sectors as well and are known for bringing innovative business models.

With the advent of planned economy in 1951, special role was earmarked for SMEs, which was given a fillip by the subsequent progressive industrial policies. The Micro, Small, and Medium Enterprises Development (MSMED) Act, 2006 provided for facilitating the promotion and development and enhancing the competitiveness of MSMEs (commonly referred to as SMEs) and for the related matters. A big leap for SMEs was witnessed in 2010, with "The Prime Minister's Task Force" recommending setting up of dedicated stock exchange/platform for SMEs. SEBI, through its circular dated May 18, 2010, laid down framework for setting up a stock exchange/trading platform dedicated to SMEs.

SME exchange overview

An SME Exchange is a stock exchange dedicated for trading the shares / securities of SMEs who otherwise find it difficult to get listed on the Main Board. The concept originated from the difficulties faced by SMEs in gaining visibility and attracting sufficient trading volumes when listed along with other stocks on the Main Board of stock exchanges. World over, dedicated SME trading platforms or exchanges are prevalent, which are known by different names such as 'Alternate Investment markets' or 'growth enterprises market', 'SME Board' etc. Some of the known markets for SMEs are AIM (Alternate Investment Market) in UK, TSX Ventures in Canada, GEM (Growth Enterprise Market) in Hong Kong, MOTHERS (Market of the high-growth and emerging stocks) in Japan, Catalist in Singapore and the latest initiative in China - Chinext. As a matter of fact, NASDAQ also started as an SME exchange.

In India, "SME Exchange" is defined in Chapter XB of the Securities and Exchange Board of India (Issue Of Capital And Disclosure Requirements) Regulations as a trading platform of a recognized stock exchange or a dedicated exchange permitted by SEBI to list the securities issued in accordance with Chapter XA of SEBI (ICDR) Regulations and this excludes the Main Board (which is in turn is defined as a recognized stock exchange having nationwide trading terminals, other than SME exchange).

To be listed on the SME Exchange, the post-issue paid up capital of the company should not exceed INR 25 Crore. This means that the SME Exchange is not limited to the Small and Medium Scale enterprises which are defined under "The Micro, Small and Medium Enterprises Development Act, 2006" as enterprises where the investment in plant and machinery does not exceed INR 10 Crore. As of now, to get listed on the Main Board of National Stock Exchange (NSE), the minimum paid up capital required is INR 10 Crore and that of Bombay Stock Exchange (BSE) is INR 3 Crore. Hence, those companies with paid up capital between INR 10 Crore to INR 25 Crore has the option of migrating from SME Exchange to the Main Board or vice versa. The companies listed on the SME exchange are allowed to migrate to the Main Board as and when they meet the listing requirements of the Main Board and there shall be compulsory migration of SMEs from the SME exchange, in case their post issue paid up capital exceeds INR 25 Crore.

BSE, as an Exchange, is the first-one to seize the initiative followed by NSE, both of them have come up with their SME Exchanges to leverage their respective trading platforms developed over the period.

Need for SME exchange

Despite the benefits associated with public listing, the SMEs were not able to access the capital markets through extant Stock Exchanges due to several factors such as stringent

regulatory, disclosure and financial requirements and the like. The creation of a separate stock exchange for SMEs has been on the policy makers' agenda for quite some time, and finally in March, 2012, SME Exchange was launched. A dedicated stock exchange for SMEs would allow them accessing capital markets easily, quickly and at lesser costs.

The need of a dedicated SME Exchange can be attributed to several factors including the following:

- A dedicated SME exchange will provide SMEs with equity financing opportunities to grow their business - from expansion to acquisitions
- Listing the company would facilitate expansion of the investor's base, which in turn help company get secondary market for equity financing, including private placement.
- With the availability of equity financing options, the debt burden can be set lower resulting in a healthier balance sheet and lowered financing cost
- Company's visibility will improve with the coverage from analysts and media that can add to the credence and image of the SME leading to benchmarking its fair value
- The listing would result in an increased participation by venture capital players as they would have a ready, transparent and tax-efficient exit route.
- Listing would add value to the companies who wish to make use of ESOPs and other stock base compensation plans as a tool to reward and retain their employees. It is expected to encourage innovation and entrepreneurial spirit, much required from the perspective of Indian national economy.
- Capital Market allows distribution of risk efficiently by transferring risk to those who are best able to bear it.
- SME sector will grow better on two pillars of financial system, i.e., banking for debt capital and Capital Market for equity capital.

A Global Comparison of SME Exchange

<i>Country</i>	<i>UK</i>	<i>Japan</i>	<i>Singapore</i>	<i>China</i>
SME Exchange	AIM	MOTHERS	CataList	Chinext
Date of Induction	1995	1999	2007	2009
No. of Companies	2494	178	134	356
Market Capitalization	GBP 60622 million	N/A	N/A	RMB 2.7 trillion (Dec 2011)
Average Monthly Turnover	GBP 3410.7 million	2000 million Yen	N/A	16,830 million Yuan
Relative Main Board	London Stock Exchange	NIKKEI	SGX	Shanghai Stock Exchange

SEBI ICDR Regulations as Applicable to SMEs-

With a view to facilitate the necessary provisions needed for SME Exchange, amendments have been made to the SEBI ICDR Regulations and a separate Chapter X-A has also been inserted therein. The regulations emphasized on the following:

Salient features

- *Reduced paid up Capital threshold* : An issuer company whose post-issue paid-up capital is not more than INR 10 Crore shall be eligible to list its securities on the SME exchange. Those issuer companies, whose post-issue paid-up capital lies between INR 10 Crore and up to INR 25 Crore, have the option to list their securities either under the provisions of this Chapter XB, i.e. on SME Exchange or on Main Board by complying with the relevant terms and conditions prescribed under the SEBI ICDR Regulations. As per the provisions of the SEBI ICDR Regulations, a minimum paid up capital of INR 10 Crore is required for listing of securities on any Main Board of BSE / NSE.
- *Filing of the offer document* : The offer document is required to be submitted to the merchant banker who, in turn, will file it with SEBI along with the new Form H. A prospectus in relation to the issue shall also be filed with the SME Exchange and the jurisdictional Registrar of Companies. It has been specifically mentioned that SEBI will not scrutinize the offer document of an SME IPO.
- *Underwriting* : Underwriters to the issue under Chapter XA shall ensure that the issue is 100% underwritten and that a disclosure to that effect is made to SEBI, a day prior to the opening of the issue. A minimum of 15% of the issue size is mandated to be underwritten by the merchant bankers. Certain Nominated Investors may be permitted to enter into contractual arrangements with the merchant bankers to share the burden of devolvement of underwriting obligations; however such contractual arrangements shall be subject to the prior approval of the SME Exchange. In case the underwriters or the Nominated Investors fail to achieve the minimum subscription, the merchant banker shall be required to fulfill its underwriting obligations.
- *Minimum Application Size and Number of Investors* : Minimum application size in an SME IPO is fixed at INR 100,000 per application as opposed to the minimum application value ranging from INR 10,000 to INR 15,000 per application under Main Board IPO. Further, the minimum number of allottees in an SME IPO should be at least 50.
- *Migration to SME Exchange* : A listed issuer whose post-issue paid-up capital is less than INR 25 Crore has an option to migrate to the SME Exchange, subject to the approval of its shareholders and compliance with the eligibility criteria laid down by the SME Exchange.
- *Migration from SME Exchange* : Companies listed on the SME Exchange shall compulsorily migrate to the Main Board of the Stock Exchanges if their post-issue share capital is in excess of INR 25 Crore. Upon the performance of any rights issue/ preferential issue/ bonus issue which results in triggering of the above limit, then such company would have to compulsorily migrate to the Main Board. Such companies shall, therefore, be required to comply with the provisions of the Listing Agreement of

the Main Board and all regulatory requirements including compliance with SEBI ICDR Regulations for the purposes of the same.

- *Market-making* : The merchant banker to the issue shall bear the responsibility of compulsory market making for a minimum period of 3 years. The securities being bought and sold as part of the market making shall ultimately get transferred to the Nominated Investor. During the compulsory market-making period, the market makers are restricted from buying any securities from the promoters/ promoter group of the issuer or any other acquirer. The promoters may, therefore, be allowed to dilute their shareholding either through offer for sale or to an acquirer. However, the promoters' shareholding which is not locked-in may be traded with the prior permission of the SME Exchange. In case, the value of the shareholding of the Nominated Investors falls below INR 1 Lakh, for any reason whatsoever, the market maker is obligated to buy the entire shareholding of such investor in a single lot. Acquisitions of shares by the merchant bankers / market makers are exempted from the SEBI Takeover Code, provided that such merchant bankers/ market makers do not have the intention of taking over the management and there is no resultant change in control (direct or indirect) of the issuer company.

SME Listing Agreement

SEBI in order to encourage promotion of dedicated exchanges and/or dedicated platforms of the exchange for listing and trading of securities issued by Small and Medium Enterprises ("SME"), and in order to facilitate listing of specified securities in the SME Exchange, has facilitated a separate Model Listing Agreement" to be executed between the issuer and the stock exchange.

SME listing agreement is similar to the Main Board equity listing agreement. However, certain relaxations are provided to the issuers whose securities are listed on SME Exchange in comparison to the listing requirements in Main Board, which *inter-alia* include the following:

1. Companies listed on the SME Exchange may send their shareholders, a statement containing the salient features of all the documents (in abridged form), as prescribed in proviso to section 219(b)(iv) of the Companies Act, 1956 instead of sending a full annual report.
2. Periodical financial results may be submitted on "half yearly basis", instead of "quarterly basis" under Clause 41
3. SMEs need not publish their financial results in newspapers, as required in the Main Board equity listing agreement.

Contribution of SME towards GDP growth of India as per the report

In mastercard's 'Micro Merchant Market Sizing and Profiling Report' released in collaboration with Confederation of All India Traders, the company has claimed small businesses make up for 45% of India's GDP , around three times of what Corporate India contributes. The sector is also said to be employing close to 46 Crore people, and growing at 11.5% annually.

India is pre-dominantly a cash-based economy, with less than 5% of the country's personal consumption expenditure of \$1.1 trillion transacted via digital payments.

"Cash can cost businesses up to 2% of their operating costs, including labor over-heads. Cash is not free", Ravinder S. Aurora, Group Head, Global Policy Affairs and Community Relations at MasterCard said.

The country currently with a population of over 1.2 billion has a mere 12 lakh POS terminals. Aurora claims a mere 1.5% of the 10 crore of India's small traders currently have cards.

"As a consumer, the transactional cost is a major deterrent. The government should offer tax breaks and incidental benefits as incentives to digital payments. Currently only 5% of the cards issued are used for online payments. With incentives it can be bumped up to 30%. That's way more than the 2% transactional fee banks make", Praveen Khandelwal, National Secretary General, CAIT said. Mastercard has promised to get over 500 million new consumers onto the digital payments bandwagon by 2020, and Aurora claims India is a major strategic market for the company.

The advent of advanced technology is opening newer channels for businesses across several sectors. This is particularly true for B2B ecommerce firms focused on the Indian SME sector. Hitherto overlooked, the presence of innovative technological platforms is bringing on board a rising number of small players including the neighborhood kirana store. This is a win-win situation for all involved enabling.

Institutional Trading Platform (ITP) An Overview

⁶The institutional trading platform (ITP) will be a new window on stock exchanges where e-commerce, data analytics, bio-technology and other startups can list and trade on their shares.

To encourage early-stage ventures to list here, SEBI has relaxed many of the more stringent rules governing IPOs. On the ITP, promoters' capital will be locked in only for six months, against the three year lock-in for normal IPOs. There is also no need to make elaborate disclosures on how IPO funds will be used.

The company that lists on the ITP will be given an option to migrate to the main board after three years. However, having relaxed many rules that protect investor interests in IPOs, SEBI has made sure that only institutional investors and HNIs invest in the new ITP.

The minimum application requirement for participation in these IPOs has been set at a high INR 10 Lakh. Only institutional investors and investors other than retail individuals will be allowed access to the new platform.

Note that this is not the first ITP being introduced by SEBI. An ITP for small and medium enterprises was opened up in 2013 and will continue to function parallelly.

Importance of ITP

India is losing the race with other global markets on the market capitalization of its listed universe. India's public market hasn't grown much in recent years compared to China or developed markets, though many Silicon Valley enterprises are powered by Indians.

Also, if exciting new-age companies in India skip domestic listing and go overseas, how will young Indians participate in their growth story? If startups are encouraged to list locally, the listed universe can expand. This can draw in dollar trades by FPIs in these companies, which would have been otherwise lost to Singapore or the US.

Valuations of internet companies have zoomed in the last few years giving their investors mind-boggling returns. But Indian investors, even the ones with the appetite for such risks, have lost out on the opportunity with most tech startups in the country taking the private equity route to funding or going outside India to list. A classic example is the home-grown MakeMyTrip, which was listed in Nasdaq a couple of years ago.

Now that SEBI has opened up the ITPs, more internet startups may list in India and you may also get to ride the e-commerce boom.

Yes, many of these startups may not be profitable and are still testing the waters on what is the right business model and market strategy. But by shepherding them on to the new ITP, SEBI is ensuring that those who have the stomach for risks can take it.

Conclusion

Understanding the link between startups –ITP- SME

In order to facilitate capital raising by small and medium enterprises including start-up companies which are in their early stages of growth and to provide for easier exit options for informed investors like angel investors, VCFs and PEs etc., from such companies, SEBI has decided to permit listing without an Initial Public Offer and trading of specified securities of small and medium enterprises (SMEs) including start-up companies on Institutional Trading Platform (ITP) in SME Exchanges. This gives SMEs and start-ups wider visibility and will allow them to raise capital through trading of specified securities without having to go through the lengthy and complex IPO process. Moreover, the ITP will give angel investors, venture capital firms and other investors to invest their money in a more secured and transparent manner and granting them easier entry and exit mechanism for such investment. While such companies are not permitted to raise equity capital through public issue, they can continue to make private placement. The legal framework for such listing and trading of the specified securities on the ITP was laid down vide SEBI (Listing of Specified Securities on Institutional Trading Platform) Regulations, 2013 (ITP Regulations). With the phenomenal rise of the Start-up ecosystem in India, along with the increase in investments by VCs and private equity funds, SEBI has recently come out with the final set of rules and regulations for ITP-Institutional Trading platform by SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 (ICDR Regulations) by inserting a "Chapter XC" on "Listing and Issue of Capital by Small and Medium Enterprises on Institutional Trading Platform without initial public offering". Further, vide said ITP Regulations, consequential amendments have also been made to SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 and SEBI (Delisting of Equity Shares) Regulations, 2009. Just a day before the Independence Day, SEBI came up with the SEBI (Issue of capital and disclosure requirement) (Fourth Amendment) Regulation, 2015 to facilitate listing of start-ups on ITP in India and to encourage start-ups to raise fund domestically rather than going abroad. According to NASSCOM estimates in 2014, India has more than 3000 startups and is the third largest base in the world. Most of the tech startups in the country were taking the private equity route for funding or were going outside India to

list. Standard example of the same is homegrown Makemytrip which was listed in Nasdaq few years ago. Now that SEBI has opened up ITPs, more start-ups may list in India and may also get to ride e-commerce boom. Understanding the necessity of this platform our Prime Minister, Mr. Narendra Modi, in the 69th Independence day's speech has announced a new campaign 'Start-up India, Stand-up India' with a motive to make India number one in Start-ups.

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Emerging Alternate Capital Market Place (Start-ups, ITP, SME)

CS Ketaki Karandikar*

Introduction

Capital market is the backbone of the stock markets in India. It is also called as secondary market. An entity introduces its securities in the primary market through Initial Public Offer (IPO). After completion of the IPO, the securities are listed on the main board of the recognized stock exchanges. Such securities are then put in the secondary market (i.e., Capital market) for trading.

In common parlance, it means, that second hand securities are traded, cleared and settled in the capital market. Different types of securities which are listed on stock exchanges are traded in the capital market. In order to understand the SME and ITP of India, we first have to understand what main board is.

Main board is nothing but the recognized stock exchange having nationwide trading platforms or terminals. In India, Bombay Stock Exchange Limited (BSE) and National Stock Exchange of India Limited (NSE) have nationwide trading platforms, hence known as recognized stock exchanges.

Entities such as public limited companies in private sector, central and state government corporations, financial institutions, municipal bodies list their securities on the main board of stock exchanges.

Listings of securities on main board provide benchmark to the securities as well as establish trend of market growth.

These are the entities which have large size and suitable capacity to handle IPO and matters related to it. The entities belonging to the small and medium scale industry have neither the size nor the capacity to undergo the mammoth task of IPO. In spite of having huge potential of growth, they do not attempt to go public. The problem about listing of small and medium enterprises (SMEs) is two sided.

The number of SMEs is larger in number than the large scale entities existing in India. Their growth potential is crucial for expansion of the economy. Such entities had access to capital market via debt listing, but not equity listing. This is where the idea of creating a new platform of listing for SME came forth.

* Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

Listing on SME platform has many advantages from the point of view of the entities and the economy of the nation as a whole. It provides stability to the debt – equity ratio of the entities. It helps to enhance liquidity in the capital market and creates wealth for all the stakeholders.

In view of this, the Securities and Exchange Board of India (Board/ SEBI) gave its in-principle approval to the stock exchanges for establishing the SME Exchange. On 13th March 2012, BSE launched its BSE SME segment and a few months after this, NSE started its NSE Emerge.

The SMEs with the paid up capital between Rs. 10 crores and Rs. 25 crores can list their specified securities on the SME Exchange. Here, specified securities mean equity shares and convertible securities.

Following are the benefits of listing on SME exchange

1. Minimal expenses of handling IPO.
2. Waiver from filing draft Red Herring Prospectus (DRHP), obtaining in principle approval from the Board and issuing public notice regarding IPO.
3. Filing of offer document by merchant banker with the Board is sufficient.
4. Requirement of filing the prospectus or the letter of offer, as the case may be with the SME exchange and the Registrar of Companies by the issuer.
5. 100% underwriting by the merchant bankers.
6. Mandatory requirement of underwriting at least 15% of the issue size on Merchant banker's account.
7. Simplification of listing process and compliances.
8. Compulsory market making for 3 years, unlike on the main board.
9. Completion of Process of listing within 2-3 months compared to the period of 8-9 months required for listing on main board.
10. Provision for migration from SME Exchange to Main Board and vice versa.
11. Easy access to alternate funding options for listed entities, like ADRs, GDRs.
12. Long term capital gains tax benefits for investors.
13. Facility of easy exit for investors at any point of time.
14. Minimal listing requirements – half yearly submission of financial results, statements of deviation/ utilization of funds, shareholding pattern etc.
15. Classification of entities into companies and body corporate in case of corporate governance requirements. The entities shall follow the requirements up to the extent they do not violate their respective statutes, guidelines or directives etc.

Following are salient features of listing on SME segment

1. The issuer entity must be a company registered as per the provisions of the Companies Act, 1956/2013.
2. The post issue paid up capital shall not exceed Rs. 25 crores.

3. The issuer company has not been referred to Board of Industrial and Financial Reconstruction (BIFR).
4. No petition for winding up has been admitted by any court of competent jurisdiction in India.
5. No material regulatory and disciplinary action against the issuer company by a stock exchange or any regulatory authority in the past 3 years.
6. The minimum application size shall be at least Rs. 1 lakh.
7. Number of allottees must be at least 50.
8. All the underwriting and subscription agreements made by the merchant banker shall be disclosed.
9. If any of the underwriters fail to fulfill their underwriting obligations, then the merchant banker shall fulfill them.
10. Submission of due diligence certificate by merchant banker as per prescribed format and requirements.
11. The entity is required to maintain a functional website.
12. Promoters' shareholding shall not be eligible for offer to the market maker during the first three years from the date of listing.

Migration to SME Exchange:

A listed entity having paid up share capital below Rs. 25 crores may list its specified securities on the SME exchange, if it satisfies below conditions:

- (a) If its members approve it by passing a special resolution through postal ballot where the votes cast in favour of migration by the non promoter members are twice the votes cast against it by other non promoter members; and
- (b) The entity fulfills all the eligibility conditions of listing.

Migration to Main Board

In following cases an entity can list its securities from the SME segment to the main board:

(a) *Indirect Listing*

Increase in paid up capital beyond Rs. 25 crores due to rights issue, bonus issue, preferential issue etc. For listing following conditions must be fulfilled:

- The members of the entity pass the special resolution through postal ballot where, the votes cast in favour of migration by non promoter members are twice the votes cast against it by other non promoter members.
- The entity obtains in principle approval from the Main Board for listing of its specified securities.
- It fulfills all the eligibility criteria of listing on the main board.

(b) *Direct Listing:*

An entity whose post issue paid capital is more than Rs. 10 crores and below Rs. 25

crores may migrate its securities from the SME segment to the Main Board if it fulfills the following conditions:

- The members of the entity pass the special resolution through postal ballot where, the votes cast in favour of migration by non promoter members are twice the votes cast against it by other non promoter members.
- It fulfills all the eligibility criteria of listing on the main board.

There are in total 184 companies listed on the BSE SME segment. Out of which 154 entities are listed till date. Out of 154, 151 entities are eligible for trading while 4 are suspended from trading. There are approximately 60 entities listed on NSE Emerge till date.

Institutional Trading Platform (ITP)

Apart from SME segment, there is another avenue for certain entities to list their securities on the Institutional Trading Platform (ITP).

NSE's Emerge ITP describes this platform as:

“It is a platform for Start-Ups and Small and Medium Enterprises which do not have their securities listed on any recognised stock exchange and which seek listing of their specified securities exclusively on the institutional trading platform for informed investors.”

The benefits of Listing on ITP

1. Facilitate capital raising by small and medium enterprises including start-up companies which are in their early stages of growth.
2. Provide easier entry and exit options for informed investors like angel investors, Venture Capital Funds (VCFs) etc., to and from such companies.
3. Provide better visibility and wider investor base.
4. Relaxed compliance and cost effective listing.
5. Tax benefits to long term Investors.

This platform provides the facility of listing the specified securities with or without IPO to eligible entities only. The ITP segment is accessible to institutional as well as non institutional investor. The provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 apply to the ITP segment as well.

The minimum trading lot on ITP for investors shall be Rs. 10 lakhs.

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 provides the definition of institutional investor as –

- (i) qualified institutional buyer; or
- (ii) family trust or systematically important NBFCs registered with Reserve Bank of India or intermediaries registered with the Board, all with net-worth of more than five hundred crore rupees, as per the last audited financial statements.

Following entities are eligible to list its specified securities on ITP segment

- (a) an entity which is intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition and at least twenty five per cent of its pre-issue capital is held by qualified institutional buyer(s) as on the date of filing of draft information document or draft offer document with the Board, as the case may be; or
- (b) any other entity in which at least fifty per cent of the pre-issue capital is held by qualified institutional buyers as on the date of filing of draft information document or draft offer document with the Board, as the case may be.

Additional condition requires that, no person, individually or collectively with persons acting in concert, shall hold twenty five per cent or more of the post-issue share capital in an entity specified above.

Listing without public issue

- (a) The entity shall file a draft information document with the Board with necessary documents.
- (b) The draft information document shall contain the disclosures the specified disclosures.
- (c) Conditions regarding allotment, issue opening/ closing, advertisement, underwriting, pricing etc shall not be applicable to this type of listing.
- (d) The entity shall obtain in principle approval from the recognized stock exchanges where it wishes to list its securities.
- (e) The securities shall be listed within 30 days from the date of issuance of observations by the Board or after the expiry of 30 days from the filing of draft information document with the Board.
- (f) Provisions relating to attainment of minimum public shareholding shall not apply in this case.
- (g) The draft and final information document shall be approved by the board of directors and signed by all the directors, CEO/ Managing Director/ Manager and CFO.
- (h) The liability shall be imposed on the designated persons for misstatements in information document.

Listing pursuant to public issue

- (a) An entity shall file a draft offer document along with necessary documents with the Board.
- (b) The minimum application size shall be Rs. 10 lakhs.
- (c) The number of allottees shall be more than 200.
- (d) The offer document shall disclose the broad objects of the issue.
- (e) The mode of allotment to institutional investors shall be disclosed prior to or at the time of filing of the Red Herring Prospectus.

- (f) Any under subscription in the non institutional investor category shall be available for subscription under the institutional investors' category.
- (g) The disclosures regarding issue price shall have appropriate information to caution the investors.

Provisions in the SEBI (ICDR) Regulations, 2009 are also made for exit of entities listed without making a public issue and migration to main board.

In India, BSE SME has its ITP segment and NSE Emerge has its Emerge ITP platform for startup entities and small and medium scale entities having innovation as their main feature of business.

Overview

Both the segments are expanding gradually. They give us the picture of sophisticated investing ways in Indian stock markets. The digital system has made it possible for individual investor to make an informed decision before investing in the capital market.

As professionals, company secretaries in employment and in practice have large opportunities to tap in these segments. Everything is there in the statute and in the working of the SEBI, stock exchanges and other stakeholders. There are many avenues which still remain untouched for professionals like company secretaries. What we have to do is to choose.

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The benefit of ITP is that entities can list their securities, with or without public issue.

Secondary Markets - The Evolution, Constituents and Trading in Stocks

CS Jyothi Mishra*

Introduction

The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. The Indian Secondary Market has witnessed fundamental Institutional changes. Electronic Financial Services have modernized the Stock Exchanges, leading to drastic reduction in transaction costs and significant improvements in Efficiency, transparency and safety when trading leading to increased Trading Volumes and Market Capitalization. There have been a number of crashes throughout history which has affirmed the requirement of setting of stricter regulatory framework and continuous changes in ways of monitoring of markets which in turn brings improvement in Investor's Confidence. In the current context of globalization and the subsequent integration of the global markets this paper captures the similarities and patterns in the activities and movements of the Indian Stock Market vis-a-vis international markets of developed nations.

Secondary Market the 'Aftermarket'

The secondary market enables those who hold securities to adjust their holdings in response to changes in their assessment of risk and return. The stock market or secondary market ensures free marketability, negotiability and price discharge. For these reasons the stock market is referred to as the nerve centre of the capital market, reflecting the economic trend as well as the hopes, aspirations and apprehensions of the investors. This secondary market has further two components, one, the spot market where securities are traded for immediate delivery and payment, the other is futures market where the securities are traded for future delivery and payment. Another variant is the options market where securities are traded for conditional future delivery. Options may further be divided into Put (buy) and Call(sell) options.

'Instruments' in Secondary Market

Financial instruments innovation has been a continuous and integral part of growth of the capital markets. A variety of factors such as fluctuation in interest rate, volatility in price, change in tax structures and regulatory changes etc. plays an important part in financial innovation. In finance, innovation involves adapting and improvising on existing products and concepts. Eg. Not very recently 'Masala bonds' came into picture. These bonds are issued outside India but denominated in Indian Rupees, rather than the local currency. Masala is an Indian word and it means spices. The term was used by IFC to evoke the culture and cuisine

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of India. The first Masala bond was issued by the World Bank backed International Finance Corporation in November 2014. Later in August 2015 International Financial Corporation for the first time issued green masala bonds to be used for private sector investments that address climate change in India.

Basic Classification of Instruments

- Equity Shares
- Shares with Differential Voting Rights
- Preference Shares
- Fully Convertible Cumulative Preference Share (Equipref)
- Debentures
- Sweat Equity Shares
- Secured Premium Notes
- Equity Shares with detachable warrants
- Dual Option Warrants
- Debt Instruments with Debt Warrants
- Debt for Equity Swap
- Different types of Bonds & Notes
- Global Depository Receipts
- Foreign Currency Convertible Bonds
- Indian Depository Receipts
- Tracking Stocks
- Mortgage Backed Securities
- Futures
- Options
- Hedge Funds
- Exchange Traded Funds
- Fund of Funds

Comparison of Indian Stock Markets with that of developed nations

Exchanges are now crossing national boundaries to extend their service areas and this has led to cross-border integration. Also, exchanges have begun to offer cross-border trading to facilitate overseas investment options for investors. The Indian stock market is the world 3rd largest stock market on the basis of investor base. NSE alone is among the 5 biggest stock exchanges in the world in terms of transactions volume. This is important to understand what forms the basis of comparison of stock exchanges both qualitatively and quantitatively.

A. Qualitative Analysis

In this, the various stock exchanges are compared on the following parameters:

(a) Market Capitalization

The market capitalization gives an idea about the size of the respective exchanges. The below picture depicts India's position based on the M-cap.

Rank	Market	Mkt Cap (US\$ trillion) October 2016	Mkt Cap (US\$ trillion) October 2003	% Change
1	U.S.	23.8	12.70	87%
2	China	6.6	0.42	1479%
3	Japan	5.2	3.10	68%
4	Hong Kong	4.1	0.83	394%
5	U.K.	3.0	2.20	36%
6	Canada	1.9	0.74	157%
7	France	1.9	1.30	46%
8	Germany	1.8	0.94	91%
9	India	1.7	0.23	639%
10	Switzerland	1.4	0.66	112%
	Top 10	51.4	23.12	122%
	World	65.6	28.10	133%

Source: Bloomberg

www.truewealthpublishing.asia

(b) Number of listed securities

The number of listed securities acts as an indicator for the volume and liquidity of any exchange. The Bombay Stock Exchange in India has the largest number of equities listed. USA is the number one in terms of stocks listed. The three stock exchanges in the USA (NYSE, Amex and NASDAQ) have a total of 5,598 Cos. trading in them. The number two is BSE and the third is The TSX group of Canada.

(c) Listing agreements

Different listing requirements of SEs are as follows:

NASDAQ

Each company must have a minimum of 1,250,000 publicly-traded shares upon listing, excluding those held by officers, directors or any beneficial owners of more than 10% of the company. In addition, the regular bid price at time of listing must be \$4, and there must be at least three market makers for the stock. However, a company

may qualify under a closing price alternative of \$3 or \$2 if the company meets varying requirements. Each listing firm is also required to follow Nasdaq corporate governance rules 4350, 4351 and 4360. Companies must also have at least 450 round lot (100 shares) shareholders, 2,200 total shareholders, or 550 total shareholders with 1.1 million average trading volume over the past 12 months.

Bombay Stock Exchange

Eligibility Criteria for IPOs/FPOs: Companies have been classified as large cap companies and small cap companies. Company with a minimum issue size of Rs. 10 crores and market capitalization small cap company is a company other than a large cap company.

National Stock Exchange

Eligibility Criteria for New companies (IPOs)

- Paid Up capital not less than 10 crores & Market Capitalisation not less than 25 crores.
- At least three years track record
- The company has not been referred to the Board for Industrial and Financial Reconstruction (BIFR).
- The networth of the company has not been wiped out by the accumulated losses resulting in a negative networth.
- The company has not received any winding up petition accepted by a court.
- ‘Promoters’ mean one or more persons with a minimum 3 years’ experience of each of them in the same line of business and shall be holding at least 20% of the post issue equity share capital individually or severally.
- No disciplinary action by other stock exchanges and regulatory authorities in past three years.

Existing Companies listed on other stock exchanges

- Paid up Capital not less than 10 crores Market Capitalization not less than 25 crores.
- Minimum Listing Requirements for companies listed on other stock exchanges.
- The company must have minimum issued and paid up equity capital of Rs. 3 crores.
- The Company should have profit making track record for last three years.
- Minimum net worth of Rs. 20 crores.
- Minimum market capitalization of the listed capital should be at least two times of the paid up capital.

(d) *Circuit filters*

The circuit filters give an insight into the risk management framework of the exchange

Exchange	% Change to trigger circuit breaker
NSE	Market – Wide 3 stages-10%, 15%, 20% of Index movement Individual Scrips (Depending upon scrip type) 2%, 5%, 10% movement of individual scrip
BSE	Same as NSE
Tokyo Stock Exchange	2 stage – 5%,10%
NYSE	3 Stage – 10%, 20%, 30% (set every year)
Korean Stock Exchange	Single Stage – 10%

Source: Author- Debjiban Mukherjee, *Comparative Analysis of Indian Stock Market with International Markets*

(e) *Settlement*

This segment takes care of the efficiency issue of the said stock exchange. It basically looks into the speed at which any of the numerous transactions affected in the market gets settled. This is especially crucial given the volume

Below are the various settlement cycles for the stock exchanges.

<i>Exchange</i>	<i>Settlement Cycle</i>
NSE	T+2
BSE	T+2
NYSE	T+3
Tokyo Stock Exchange	T+3
Hongkong Stock Exchange	T+2

Source: Author- Debjiban Mukherjee, *Comparative Analysis of Indian Stock Market with International Markets*

The efficiency of a stock exchange has been measured in terms of its settlement process.

B. Quantitative Analysis

The hypothesis that the exchanges impact each other has been tested through various statistical methods with data on price, returns collected from the exchanges. Mainly the correlation analysis, exponential trend analysis and the risk-return analysis has been used to validate the hypothesis.

Historical Context

The world's first stock markets are generally linked back to Belgium. Bruges, Flanders,

Ghent, and Rotterdam in the Netherlands all hosted their own “stock” market systems in the 1400s and 1500s. The need for securities market was not felt till the time things went wrong. In London, businesses would open up overnight and issue stocks and shares of some crazy new venture. There was no regulation Companies stopped paying dividends to investors and the government of England banned the issuing of shares until 1825. That’s why the creation of the New York Stock Exchange (NYSE) in 1817 was such an important moment in history. The NYSE has traded stocks since its very first day.

The London Stock Exchange was the main stock market for Europe, while the New York Stock Exchange was the main exchange for America and the world. Today, virtually every country in the world has its own stock market. In 1971, two organizations – the National Association of Securities Dealers and Financial Industry Regulatory Authority – created the NASDAQ stock exchange.

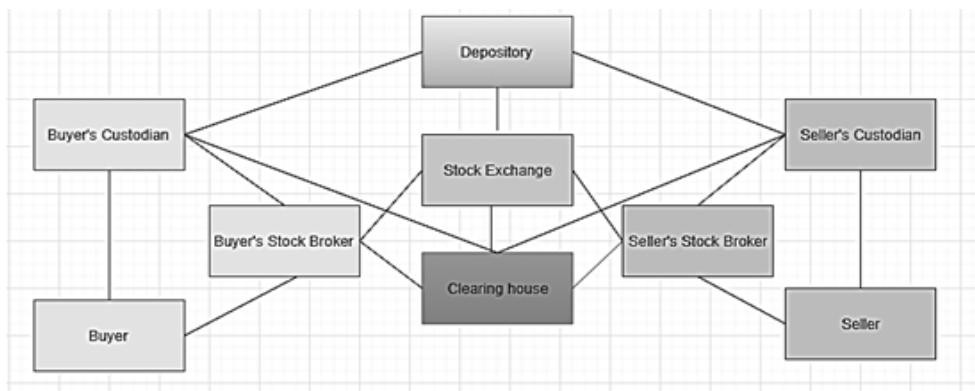
Indian stock market marks to be one of the oldest stock market in Asia. In the 1830s, trading on corporate stocks and shares in Bank and Cotton presses took place in Bombay. The informal group of stockbrokers organized themselves as the TheNative Share and Stockbrokers Association which, in 1875, was formally organized as the Bombay Stock Exchange (BSE).

In 1956, the Government of India recognized the Bombay Stock Exchange as the first stock exchange in the country under the Securities Contracts (Regulation) Act. The most decisive period in the history of the BSE took place after 1992. In the aftermath of a major scandal with market manipulation involving a BSE member named Harshad Mehta, BSE responded to calls for reform with intransigence. The foot-dragging by the BSE helped radicalise the position of the government, which encouraged the creation of the National Stock Exchange (NSE), which created an electronic marketplace. NSE started trading on 4 November 1994. Within less than a year, NSE turnover exceeded the BSE. BSE rapidly automated, but it never caught up with NSE spot market turnover. The second strategic failure at BSE came in the following two years. NSE embarked on the launch of equity derivatives trading.

The National Stock Exchange (NSE) is India's leading stock exchange covering 364 cities and towns across the country. NSE was set up by leading institutions to provide a modern, fully automated screen-based trading system with national reach.

Structure of Secondary Markets-How they operate

The following market intermediaries are involved in the Secondary Market:



Source: Author's Own

Regulatory Environment governing Indian Secondary Market

Indian Capital Markets are regulated and monitored by the Ministry of Finance, The Securities and Exchange Board of India and The Reserve Bank of India.

The Ministry of Finance regulates through the Department of Economic Affairs - Capital Markets Division. The division is responsible for formulating the policies related to the orderly growth and development of the securities markets (i.e. share, debt and derivatives) as well as protecting the interest of the investors.

The Division administers legislations and rules made under the

- Depositories Act, 1996,
- Securities Contracts (Regulation) Act, 1956 and
- Securities and Exchange Board of India Act, 1992.

The Regulators

Securities & Exchange Board of India (SEBI)

The Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992 and is the principal regulator for Stock Exchanges in India. SEBI's primary functions include protecting investor interests, promoting and regulating the Indian securities markets. All financial intermediaries permitted by their respective regulators to participate in the Indian securities markets are governed by SEBI regulations, whether domestic or foreign. Foreign Portfolio Investors are required to register with DDPs in order to participate in the Indian securities markets.

Reserve Bank of India (RBI)

The Reserve Bank of India (RBI) is governed by the Reserve Bank of India Act, 1934. The RBI is responsible for implementing monetary and credit policies, issuing currency notes, being banker to the government, regulator of the banking system, manager of foreign exchange, and regulator of payment & settlement systems while continuously working towards the development of Indian financial markets. The RBI regulates financial markets and systems through different legislations. It regulates the foreign exchange markets through the Foreign Exchange Management Act, 1999.

Stock Exchanges (BSE & NSE)

Participation

The capital market in India includes the following institutions (i.e., supply of funds to capital markets comes largely from these); (i) Commercial Banks; (ii) Insurance Companies (LIC and GIC); (iii) Specialised financial institutions like IFCI, IDBI, ICICI, SIDCS, SFCS, UTI etc.; (iv) Provident Fund Societies; (v) Merchant Banking Agencies; (vi) Credit Guarantee Corporations. Individuals who invest directly on their own in securities are also suppliers of fund to the capital market.

The Indian capital market is divided into gilt-edged market and the industrial securities market. The gilt-edged market refers to the market for government and semi-government

securities, backed by the RBI. The securities traded in this market are stable in value and are much sought after by banks and other institutions.

Growth and performance of Indian Markets as represented by increased volumes

India's stock market capitalisation (M-cap) has crossed \$2 trillion, making it the ninth-largest equity market globally and second, after China, in the universe of emerging markets, according to Bloomberg data. The spurt in stock prices has pushed up India's M-cap-to-GDP ratio, a tool used by equity strategists to assess the relative valuation of a market, well above the 10-year average.

What to look when participating in the secondary market-Basis of analysis

Fundamental Analysis

Fundamental analysis is a stock valuation method that uses financial and economic analysis to predict the movement of stock prices. The fundamental information that is analyzed can include a company's financial reports, and non-financial information such as estimates of the growth of demand for products sold by the company, industry comparisons, and economy-wide changes, changes in government policies etc..

Some stocks are cheap and some are costly. But the price of the stock is not important. The price of the stock does not make a stock good to buy. What is important is how much the price of the stock is likely to rise. More specifically the “percentage” rise in the stock price is important.

So fundamental analysts use different tools and ratios to compare all sorts of companies no matter what business they are in or what they do!

Fundamental Analysis Tools

Earnings per Share (EPS) :

Comparing the earnings of one company to another really doesn't make sense, if you think about it.

It makes more sense to look at earnings per share (EPS) for use as a comparison tool. This calculation is not difficult to figure out. You just take the net earnings and divide them by the outstanding shares.

$$EPS = \text{Net Earnings} / \text{Outstanding Shares}$$

Price to Earnings Ratio (P/E) :

If there's one number that people need to look at than more any other, it's the Price to Earnings Ratio (P/E).

The higher the P/E the more the market will fork over. Some investors read a high P/E as an overpriced stock. That may be the case. But it can also indicate the market has high hopes for this stock's future and has bid up the price.

What is the “right” P/E? The answer depends on your willingness to pay for earnings. The more you are willing to pay which means you believe the company has good long term prospects over and above its current position the higher the “right” P/E is for that particular stock in your decision-making process.

So for every company you scout for P/E, follow it carefully. Learn what you can about its management team, its place in a given sector (e.g., energy, high-tech, pharmaceuticals) and the opinions of expert analysts.

Projected Earning Growth – PEG

Because the market is usually more concerned about the future than the present, it is always looking for some way to project out. Another ratio you can use will help you look at future earnings growth is called the PEG ratio. The PEG factors in projected earnings growth rates to the P/E for another number to remember.

You calculate the PEG by taking the P/E and dividing it by the projected growth in earnings.

$$\text{PEG} = \text{P/E} \div (\text{projected growth in earnings})$$

So even a stock with a high P/E, but high projected earning growth may be a good value. Looking at the opposite situation; a low P/E stock with low or no projected earnings growth, you see that what looks like a value may not work out that way.

A few important things to remember about PEG:

- It is about year-to-year earnings growth
- It relies on projections, which may not always be accurate

Price to Sales – P/S

The Internet boom of the late 1990s was a classic example of hundreds of companies coming to the market with no history of earning – some of them didn't even have products yet. However, we still have the problem of needing some measure of young companies with no earnings, yet worthy of consideration. After all, Microsoft had no earnings at one point in its corporate life. One ratio you can use is Price to Sales or P/S ratio. This metric looks at the current stock price relative to the total sales per share. You calculate the P/S by dividing the market cap of the stock by the total revenues of the company.

You can also calculate the P/S by dividing the current stock price by the sales per share.

$$\text{P/S} = \text{Market Cap} / \text{Revenues}$$

or

$$\text{P/S} = \text{Stock Price} / \text{Sales Price Per Share}$$

Much like P/E, the P/S number reflects the value placed on sales by the market. The lower the P/S, the better the value, at least that's the conventional wisdom. However, this is definitely not a number you want to use in isolation. When dealing with a young company, there are many questions to answer and the P/S supplies just one answer.

Price to Book – P/B

Value investors look for some other indicators besides earnings growth and so on. One of the metrics they look for is the Price to Book ratio or P/B. This measurement looks at the value the market places on the book value of the company.

You calculate the P/B by taking the current price per share and dividing by the book value per share.

$P/B = \text{Share Price} / \text{Book Value Per Share}$

Like the P/E, the lower the P/B, the better the value. Value investors would use a low P/B in stock screens, for instance, to identify potential candidates.

Dividend Payout Ratio

The DPR measures what a company's pays out to investors in the form of dividends.

You calculate the DPR by dividing the annual dividends per share by the Earnings Per Share.

$DPR = \text{Dividends Per Share} / \text{EPS}$

Companies that pay higher dividends may be in mature industries where there is little room for growth and paying higher dividends is the best use of profits (utilities used to fall into this group, although in recent years many of them have been diversifying).

Either way, you must view the whole DPR issue in the context of the company and its industry. By itself, it tells you very little.

Dividend Yield

Dividend yield is a financial ratio that shows how much a company pays out in dividends every year in relation to its share price.

Dividend Yield Formula

$\text{Dividend Yield} = \text{annual dividend per share} / \text{stock's price per share}$

Investors who need a minimum cash flow from their investments can secure it by investing in stocks paying high, stable dividend yields.

Investors who need a minimum cash flow from their investments can secure it by investing in stocks paying high, stable dividend yields.

Book Value

Another way to determine a company's value is to go to the balance statement and look at the Book Value. The Book Value is simply the company's assets minus its liabilities.

$\text{Book Value} = \text{Assets} - \text{Liabilities}$

In other words, if you wanted to close the doors, how much would be left after you settled all the outstanding obligations and sold off all the assets.

A company that is a viable growing business will always be worth more than its book value for its ability to generate earnings and growth.

Book value appeals more to value investors who look at the relationship to the stock's price by using the Price to Book ratio.

To compare companies, you should convert to book value per share, which is simply the book value divided by outstanding shares.

Return on Equity

Return on Equity (ROE) is one measure of how efficiently a company uses its assets to

produce earnings. You calculate ROE by dividing Net Income by Book Value. A healthy company may produce an ROE in the 13% to 15% range.

While ROE is a useful measure, it does have some flaws that can give you a false picture, so never rely on it alone. For example, if a company carries a large debt and raises funds through borrowing rather than issuing stock it will reduce its book value. A lower book value means you're dividing by a smaller number so the ROE is artificially higher. There are other situations such as taking write-downs, stock buy backs, or any other accounting slight of hand that reduces book value, which will produce a higher ROE without improving profits.

It may also be more meaningful to look at the ROE over a period of the past five years, rather than one year to average out any abnormal numbers.

Technical Study

Technical analysis may appear complicated on the surface, but it boils down to an analysis of supply and demand in the market to determine where the price trend is headed. If you understand the benefits and limitations of technical analysis, it can give you a new set of tools or skills that will enable you to be a better trader or investor over the long-term.

Technical analysis is based on three assumptions:

1. The market discounts everything.
2. Price moves in trends.
3. History tends to repeat itself.

Another important tool of technical analysis charts. Major types of charts are as follows. Chart patterns look at the big picture and help to identify trading signals – or signs of future price movements. The theory behind chart patterns is based on this assumption – that certain patterns consistently reappear and tend to produce the same outcomes. Chart patterns have an established definition and criteria, but there are no patterns that tell you with 100% certainty where a security is headed.

Some of the chart patterns studied are as follows

Head and Shoulders

The Head and Shoulders is a reversal chart pattern that indicates a likely reversal of the trend once it's completed.

Cup and Handle

The Cup and Handle is a bullish continuation pattern where an upward trend has paused, but will continue when the pattern is confirmed.

Double Tops and Bottoms

The Double Top or Double Bottom pattern are both easy to recognize and one of the most reliable chart patterns, making them a favourite for many technically-orientated traders. The pattern is formed after a sustained trend when a price tests the same support or resistance level twice without a breakthrough.

Triangles

Triangles are among the most popular chart patterns used in technical analysis since they occur frequently compared to other patterns. The three most common types of triangles are symmetrical triangles, ascending triangles, and descending triangles.

Flags & Pennants

Flags and Pennants are short-term continuation patterns that represent a consolidation following a sharp price movement before a continuation of the prevailing trend. Flag patterns are characterized by a small rectangular pattern that slopes against the prevailing trend, while pennants are small symmetrical triangles that look very similar.

Wedges

The Wedge pattern is a reversal or, less commonly, continuation pattern that's similar to the symmetrical triangle except that it slants upward or downward. Rising wedges are bearish chart patterns that occur when trend is moving higher and the prices are converging and the prevailing trend is losing momentum. Falling wedges are bullish chart patterns that occur when the trend is moving lower and prices are converging, which signifies that the bearish trend is losing momentum and a reversal is likely.

Gaps

Gaps occur when there is empty space between two trading periods that's caused by a significant increase or decrease in price.

Triple Tops & Bottoms

Triple Tops and Triple Bottoms are reversal patterns that aren't as prevalent as Head and Shoulders or Double Tops or Double Bottoms.

Rounding Bottom

The Rounding Bottom – or Saucer Bottom – is a long-term reversal pattern that signals a shift from a downtrend to an uptrend and lasts anywhere from several months to several years.

Chart patterns are a valuable part of technical analysis – even if they are more art than science. Many traders use them to identify potential trades that they can confirm using other forms of technical analysis to maximize their odds of success.

Cautions in the market – What to avoid

- (a) *Buying out-of-the-money (OTM) call options* - Trading OTM calls is one of the most difficult ways to make money consistently. If you're new to options trading, consider another strategy first.
- (b) *Using an all-purpose strategy in different market conditions* - Depending on the market, you'll want to tailor your options trading strategies. Trading the long spread is a tried-and-true approach that you should understand.
- (c) *Not having a definite exit plan prior to expiration* - Even when an option trade is going your way, it's crucial to have an exit plan in advance. Otherwise, how will you make the right move at the right time?

- (d) *Making up for past losses with risky “doubling up”* - When a trade moves against you, it's tempting to ignore your tolerance for risk and make a rash decision. Don't. Instead, try another approach to mitigating your losses.
- (e) *Trading illiquid options* - The biggest drawback to this strategy is that, if you initiate or adjust an option position that's associated with low activity, you run the risk of losing money due to poor pricing.
- (f) *Waiting too long to buy back your short options* - Don't wait until it's too late to make your move, and don't think that squeezing every last penny out of a trade is worthwhile. Do the right thing.
- (g) *Failing to factor earnings and dividend date into your strategy* - Avoiding trades with pending dividends is a commonsense approach to investing in options. Understand how the trading season impacts stock volatility and can inflate option prices.
- (h) *Not knowing what to do if you're assigned early* - From the beginning, keep early assignment in mind. If you think about it strategically, you won't be caught in a bind if there's an irrational and disruptive market event.
- (i) *Failing to use index options for neutral trades* - Trading neutral on big indices may not sound exciting but this approach can shield you from costly market volatility.
- (j) *Legging into spread trades* - This is a common mistake among rookies and experienced traders hoping to squeeze the last few bucks out of a trade. Do not fall for it!

Top buy signals in markets

Stock Trends

Identifying trends is important. But how do you spot a trend? It's difficult, as the market never moves in a straight line. A stock will never fall continuously on a given day and rise on another. "Generally, higher highs and higher lows indicate an uptrend, whereas lower highs and lower lows mean a downtrend.

"Look at the trend. Look at news related to the stock

Analysts and market experts take the help of various parameters to confirm if a stock is a trade pick. The most used are available in any technical analysis software.

These include :

Moving Averages

One of the widely used tools is the 200-day moving average. You simply have to plot the 200-day moving average on the price chart. When the price of the stock rises above the moving average line, it's a buy signal, and when the price falls below the moving average line, it is a sell signal. One can also look the 50-day moving average or the 10-day moving average. Trading is a game of probability. So, you have to arrive at your own methods to decide which parameters suit you the best.

Relative Strength Index (RSI)

RSI compares the magnitude of recent gains to recent losses to see if an asset is oversold

or overbought. RSI is plotted on a scale of 0-100. Generally, if it is above 70, the stock is considered overbought and so one can look to sell it. Similarly, an RSI of less than 30 indicates the stock is oversold and can be bought.

Moving average convergence divergence (MACD)

This is a very important tool used by technical experts. You just have to select the MACD and plot it on a chart. The MACD comprises two lines, fast and slow. With technology, these calculations are automated and a graph gets plotted at the click on the mouse.

When the fast line crosses above the slow line, it's a buy signal, and when the slow line crosses the fast line, it's a sell signal.

Fibonacci Retracement

Fibonacci retracement is based on the assumption that the markets retrace by a few predictable percentages, the best known of which are 38.2%, 50% and 61.8%. So, when the market retraces 38%, it will generate either a sell or a buy call depending on the trend.

You have to plot Fibonacci retracement from the peak price. The software will give the above mentioned retracement levels. When the price reaches the 38.2% level and bounces, it means the price of the stock at which the chart plots the 38.2% retracement is the support level and you can buy. However, if the price falls below the 38.2% level, you may look at the price at 50% retracement level as your next support.

Support and Resistance

You may hear or read technical experts recommending support and resistance levels. But plotting support and resistance and finding it yourself is a simple job. As you know, prices move in a zig-zag fashion and form lows and highs. A support is plotted at the daily low price and resistance at the daily high price.

Difference between fundamental and technical analysis – two school of thoughts

Tools	Technical analysts typically begin their analysis with charts. Technical analysts believe that there's no reason to analyze the stock price already includes all relevant information	Fundamental analysts try to determine a company's value by looking at its income statement, a company's financial statements since balance sheet, and cash flow statement.
Time Horizon	Technical analysis follow short term pattern.	Fundamental analysis takes a long-term approach. While stock charts can be delimited in weeks, days, or even minutes, fundamental analysis often looks at data over multiple quarters or years.
Goal	Technical analysts try to identify many short- to medium -term trades where they can flip a stock	Fundamental analysts try to make long-term investments in a stock's underlying business.

Technical analysis and fundamental analysis are often seen as opposing approaches to analyzing securities, but many investors have experienced success by combining the two techniques. For example, an investor may use fundamental analysis to identify an undervalued stock and use technical analysis to find a specific entry and exit point for the position. Often times, this combination works best when a security is severely oversold and entering the position too early could prove costly. In short fundamental analysis tells you what to buy and technical analysis tells you when to buy.

The idea of mixing technical and fundamental analysis isn't always well-received by the most devoted groups in each school, but there are certainly benefits to at least understanding both schools of thought. Where Fundamental analysis tells you what to buy technical analysis tells when to buy.

Conclusion

The stock market is referred to as the epicentre of the economy which is representative of economic trend as well as the sentiments of the investors. Indian stock markets although evolved after many developed nations still due to its tight regulatory framework it has managed to the list of top markets and also have been proved influential in mobilising resources from the overseas markets. Over a period of time, the instruments in the stock markets have evolved and undergone changes to combat with the changing times, needs, challenge and opportunities as distant from the conventional instruments. The entry level requirements and regular requirements have been made difficult especially in case of the Indian markets. On account of the crisis and leakages happened in the past the regulations have become more and more stringent for traders of all over the world by persistent adaptation in the laws relating to stock markets. Also, Investors are being educated more and more to ascertain the risk and return of the particular stock. Now-a-days there are number of methods and tools available to make an informed decision about buying, selling or retaining a stock. One can make use of multiple techniques together and while side by side establishing connection with the ongoing dynamics of the economic conditions, various sectors and industry to take optimum advantage of the same. To sum up, totality is important otherwise there is no dearth of incidents where with the half knowledge, half research done and half preparedness, people have suffered losses from their trades.

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Analysis of SEBI's Interpretive Letters on Insider Trading Regulations, 2015

CS Gaurav N. Pingle*

With an objective to deter the practice of insider trading in the securities of listed companies, SEBI had originally framed SEBI (Prohibition of Insider Trading) Regulations, 1992. After several amendments to the Regulations and also judicial paradigm through various case laws had also evolved to prohibit insider trading. SEBI, on the auspicious occasion of Makar Sankrant & Pongal (Thursday, January 15, 2015), notified Prohibition of Insider Trading ('PIT') Regulations, 2015. The objective to substitute the Regulations was to strengthen the legal and enforcement framework, toughen the insider trading rules, align Indian regime with International practices. SEBI has also introduced few definitions, expanded the scope of existing definitions and at the same time, it has completely overhauled initial and continual disclosures by directors / KMP / employees to the company. After the introduction of SEBI (PIT) Regulations, 2015, SEBI issued various Circulars and Notification for clarifying the provisions relating to its compliance and implementation. Many listed companies approached SEBI and sought for Interpretive Letters. Under the Informal Guidance, Scheme, 2003 ('Scheme'), SEBI-registered intermediary, listed company, Mutual Fund Trustee and acquirer (or proposed acquirer) under Takeover Code can seek SEBI informal guidance in following form:

- (i) **No-action letters** : In which SEBI's Department indicates that Department would or would not recommend any action under any Act, Rules, Regulations, Guidelines, Circulars or other legal provisions administered by SEBI,
- (ii) **Interpretive letters** : In which SEBI's Department provides an interpretation of a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of proposed transaction in securities or specific factual situation.

This article is summary and analysis of SEBI's Interpretive Letters on Insider Trading Regulation, 2015.

SEBI clarifies on disclosures under Insider Trading Regulations for allotment of shares by merger/demerger/gift

Kotak Mahindra Bank sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003 and raised certain issues relating to disclosures under SEBI's Insider Trading Regulations. The Bank asked for clarification on the disclosures for certain unique

* Practising Company Secretary. The views expressed are personal views of the author and do not necessarily reflect those of the Institute.

transactions like bonus shares, shares received pursuant to the scheme of amalgamation/demerger, gift or off market transaction like transfer of shares to a family trust account, where the traded value is nil and the same cannot be considered for computing the prescribed threshold limit (Rs. 10 lacs).

Relevant Regulations : Pursuant to Reg. 7(2)(a) of SEBI's Insider Trading Regulations, every promoter, employee and director of the company to disclose to the company the number of such securities acquired or disposed of within 2 trading days of such transaction if the value of the securities traded, whether in one transaction or a series of transactions over any calendar quarter, aggregates to traded value in excess of Rs. 10 lacs or such other value as may be specified. Under Reg. 7(2)(b) of SEBI's Insider Trading Regulations, the company has to notify the particulars of such trading to the stock exchanges on which the securities are listed within 2 trading days of receipt of the disclosure or from becoming aware of such information. In the Explanation to Reg. 7(2)(b), SEBI has clarified that disclosure of incremental transactions after any disclosure shall be made when transactions effected after the prior disclosure crosses the prescribed threshold.

Crux of SEBI's Interpretive Letter & Analysis : In the Interpretive Letter, SEBI¹ has clarified that where the person getting allotment of shares has no role in the transaction in question and relevant information or disclosure of such transaction is already in the public domain (e.g. Bonus shares or shares received pursuant to Scheme of amalgamation/demerger), a separate disclosure may not be necessary. However, for all other instances (e.g. Off-market transaction or gifts, etc.), disclosure would be required under the Regulations. W.r.t. the query on valuation, SEBI stated that the term 'value of securities traded' is interpreted as the prevailing market value of the securities on the day the shares are acquired or disposed off. SEBI stated that the same may be used for the purpose of calculation of threshold value beyond which disclosure is required and must also be disclosed in the referred form. In my view, SEBI has rightly interpreted and provided clarity on the trigger point for disclosures on certain unique types of transactions.

SEBI clarifies on requirement of promoter's pre-clearance under Insider Trading Regulations, elucidates role of Compliance Officer

Kirloskar Chillers Pvt. Ltd. ('KCPL') is a part of the promoter group of Kirloskar Brothers Limited ('KBL'). The 'Promoter and Promoter Group' of KBL collectively hold 65.44% of the total paid-up capital of KBL (as on Sep. 30, 2016). KCPL currently does not hold any equity shares in KBL. Being public listed company, KBL has "Code of practice and procedures for fair disclosure of UPSI and Code of Conduct" ('COC') to regulate monitor and report trading by insiders of KBL in accordance with Insider Trading Regulation. In letter addressed to SEBI it was disclosed that, KCPL intended to acquire 50,000 equity shares, constituting 0.06% of the paid-up capital of KBL ("Proposed Acquisition"). KCPL, being qualified as Promoter group entity of KBL, was required to adhere to requirements contained in the COC i.e. obtaining pre-clearance from KBL's Compliance Officer for the proposed acquisition. At the time of obtaining pre-clearance, KCPL submitted the requisite declaration/undertaking that it does not possess any UPSI. The Compliance Officer rejected the application without any valid grounds. The

1 SEBI Letter No. ISD/OW/9966/2017 dated April 28, 2017.

Compliance Officer attempted to justify the said rejection by stating certain reasons. Based on this background, KPCL sought guidance from SEBI on legal provisions relating to requirement of pre-clearance from the Compliance Officer and the grounds on which pre-clearance can be rejected by the Compliance Officer.

Crux of SEBI's Interpretive Letter & Analysis : In its introductory remarks of the Interpretive Letter, SEBI² pointed out that Insider Trading Regulations are prohibitive Regulations and the applicability of its provisions, is w.r.t. Insiders and such concerned securities to which UPSI might pertain. This is to ensure that there is no undue advantage accrued to such class of investors, on account of their access to UPSI at the expense of general market participants. SEBI clarified that the pre-clearance is required to be obtained only by "Designated persons" if the value of the proposed trades is above such thresholds as stipulated by the board of directors. Therefore, a promoter, if designated as "Designated Person" by the board of directors in consultation with the Compliance Officer, will be required to obtain pre-clearance for trading. SEBI stated that "Schedule B of PIT Regulations casts certain obligations on the Compliance Officer which has to be complied accordingly. The Compliance Officer may approve or reject a pre-clearance request after necessary assessment as per the PIT Regulations and the Code of Conduct." SEBI referred the provisions of PIT Regulations w.r.t. the powers of Compliance Officer and observed that "*Any question with respect to the act of compliance officer whether or not extraneous to the powers so conferred according to the PIT Regulations and the Code of Conduct, may be referred to the board of directors and the audit committee for examination in accordance with the extant laws and the relevant facts of the case*". SEBI, in its Interpretive Letter, concluded by stating that the basic intent of Insider Trading Regulations is that no undue advantage accrue to certain category of investors on account of their access to UPSI. However, SEBI also stated that "*Any actions of Compliance Officers, Board of Directors or other entities entrusted with ensuring adherence to these Regulations, should be to ensure compliance in letter and spirit to the PIT regulations and not for any ulterior motive.*"

SEBI interprets Insider Trading Regulations, observes that investing through discretionary Portfolio Management Scheme amounts to 'insider trading'

HDFC Bank sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003. The Bank stated that some its employees, who may be in possession of UPSI of the Bank or of other listed companies with whom Bank deals, are consequently restricted from dealing in securities of the Bank or such other listed companies. The employees may choose to invest their funds in securities market through portfolio management schemes. The portfolio managers, under the discretionary portfolio management scheme, deals in the securities with the funds of the investors (investor includes employees of the Bank and his relative), as per its own discretion and the investor has no direct/indirect control/influence over the investment making decisions. HDFC Bank stated that the Portfolio Manager, while exercising his discretion, makes investment/disinvestment in securities, which may includes securities of Bank or securities of a listed company, for which the employee or his relative may be in possession of UPSI by virtue of being employee of the Bank, but the employee of the bank or his relative has no control directly or indirectly, over investments making decisions of the Portfolio Manager.

2 SEBI Letter No. ISD/2700/2017 dated February 3, 2017.

Understanding Discretionary Portfolio Management Scheme : Under such scheme, the day-to-day investment discretion are fully delegated to Portfolio Manager and is not shared with the investor. The Portfolio Manager does not discuss any potential investment/disinvestment decisions with investor before any transaction and the investor. The investor does not make suggestions to Portfolio Manager regarding specific investments/disinvestments and the Portfolio Manager does not advise the investor of trades prior to their execution. The Portfolio Manager does not accept specific orders to buy and sell of any security at the direction of its client. The portfolio is standard portfolio and is not altered specifically for an investor. Investments in securities of companies as a part of discretionary portfolio management scheme is identifiable and the securities in the portfolio are mandatorily held in a separate demat account with power of attorney in favour of the portfolio manager.

Crux of SEBI's Interpretive Letter & Analysis : SEBI³ issued an Interpretive Letter to HDFC Bank Ltd. and opined that investing in securities through discretionary Portfolio Management Scheme amounts to 'insider trading'. SEBI perused the provisions of Insider Trading Regulations and stated that "Dealing in securities, whether it is direct or indirect is not relevant, but that an insider when in possession of UPSI should not deal in securities of the company to which the UPSI pertains. Even while dealing in such securities through a discretionary PMS, the trades of insider shall be assumed to be motivated by knowledge and awareness of USPI". SEBI observed that "Reg. 4(1) read with Sec. 4 of Schedule B of Insider Trading Regulations, infers that the dealing by the Banks or the company with which the Bank deals in securities through discretionary PMS, when the trading window is closed, shall be assumed to be motivated by the knowledge and awareness of UPSI". SEBI has strictly interpreted the provisions of the Insider Trading Regulations and observed that investing through discretionary Portfolio Management Scheme amounts to 'insider trading'. In my view, SEBI ought to have considered 'knowledge of the trade' and 'knowledge of the UPSI' for the purpose of determining applicability of Insider Regulations. This Interpretive Letter may also affect the investments by bank employees in equity market.

SEBI interprets 'securities' & applicability of Code of Conduct under Insider Trading Regulations

Prabhudas Lilladhar Pvt. Ltd. sought for an Interpretative Letter from SEBI under SEBI (Informal Guidance) Scheme, 2003. Few of the issues raised by Prabhudas Lilladhar Pvt. Ltd. are: (i) Whether certain provisions of Insider Trading Regulation are applicable to the directors of an unlisted Market Intermediary or his immediate relative or bankers of an unlisted Market Intermediary, (ii) Whether certain bonds can also be exempted from the definition subject to no UPSI attracted inherently on such bonds, (iii) Whether Senior Professional who does not have access to UPSI can request the Compliance officer for exclusion as "designated person" under the Code of Conduct.

Crux of SEBI's Interpretive Letter & Analysis : SEBI⁴, in its introduction to the Interpretive Letter, stated that Insider Trading Regulations by nature are prohibitive Regulations. The applicability of its provisions is w.r.t. Insiders and such concerned securities to which UPSI

3 SEBI Letter No. ISD/20812/2016 dated July 25, 2016

4 SEBI Letter No. ISD/34644/2016 dated December 23, 2016

might pertain, so that there is no undue advantage accrued to such class of investors. SEBI referred to the provisions relating to ‘deemed to be connected persons’ (i.e. clause (j) Reg. 2 (1)(d)(ii)). SEBI clarified that the “Company” in the phrase “director of company or his immediate relative or banker of the company”, referred to in the clause of Insider Trading Regulations, implies a listed company to which UPSI may pertain. With respect to Prabhudas Lilladhar Pvt. Ltd.’s question on whether certain bonds can also be exempted, SEBI clarified that exclusion provided from the definition of ‘securities’ is with respect to ‘Mutual Funds units’ only. On the applicability of the Code of Conduct, SEBI stated that “Employees and connected persons are designated on the basis of functional role and not only on seniority. Code of conduct applies to all connected persons and not only to designated persons. It may further be stated that designated persons are specified by the Board of Directors in consultation with the Compliance Officer.”

Conclusion

SEBI’s Interpretative Letter can be considered as some sort of clarification on the Insider Trading Regulations. SAT in a recent ruling clarified the legal sanctity of Interpretive Letters. With reference to the Takeover Code read with SEBI’s Interpretive Letter, SAT⁵ ruled that “A straight forward reading of Reg. 10 of Takeover Regulations 2011 unambiguously shows that the Appellants were not eligible for exemption. When a straight forward reading of the Regulation/law is available that is the only way it should be read. In the instant matter no other interpretation is actually possible... When the statute is clear, informal guidance should not be relied on. Informal guidance scheme cannot be used to reduce the importance of the statute itself”. SAT observed that the guidance is the view of the concerned department of SEBI and will not be binding on SEBI. SAT observed that the letter issued by SEBI’s Department under this Scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. SAT also stated that such letter cannot be construed as SEBI’s order under Section 15T of SEBI Act, and shall not be appealable.

5. In the matter of Arbutus Consultancy LLP vs. SEBI, Order dated April 5, 2017.