Quadrant II - Notes

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Module Name: PRIMARY AND SECONDARY MARKET

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INTRODUCTION

Financial markets are broadly categorized into Money market and Capital market. The process of industrial growth requires the development of the capital market which provides long-term finance to entrepreneurs. The capital market is a wide term and includes all transactions involving long-term funds. The development banks, commercial banks, financial institutions and stock exchanges, are its important components. The Securities and Exchange Board of India (SEBI) is the regulator over the Capital Market. Capital market is an organized market for effective and efficient mobilization of funds from the numerous savers and transfers the funds to those who are in need of money to finance business operations either in the private sector or in the public sector. The Securities Market is divided into two segments--the Primary Market and the Secondary Market. The main difference between these two lies in the fact that while the former deals with the securities, which the issuer issues for the first time, the latter deals in the existing securities.

PRIMARY MARKET

The primary market is also known as the new issues market. It deals with new securities being issued for the first time. The essential function of a primary market is to facilitate the transfer of investible funds from savers to entrepreneurs seeking to establish new enterprises or to expand existing ones through the issue of securities for the first time. The investors in this market are banks, financial institutions, insurance companies, mutual funds and individuals. A company can raise capital through the primary market in the form of equity shares, preference shares, debentures, loans and deposits. Funds raised may be for setting up new projects, expansion, diversification, modernisation of existing projects, mergers and takeovers etc.

Methods of Floatation

There are various methods of floating new issues in the primary market:

Offer through Prospectus:

- Offer through prospectus is the most popular method of raising funds by public companies in the primary market.
- This involves inviting subscription from the public through issue of prospectus.
- A prospectus makes a direct appeal to investors to raise capital, through an advertisement in newspapers and magazines.
- The issues may be underwritten and are required to be listed on at least one stock exchange.
- The contents of the prospectus must be in accordance with the provisions of the Companies Act and SEBI disclosure and investor protection guidelines.

Public Issue:

- Issues are offered to the public through prospectus and the public subscribes directly.
- When the offer or invitation to subscribe for shares or debentures is made to 200 or more persons, then such an offer or invitation shall be deemed to be a public offering.
- Public issues are open to the general public.
- Wide publicity about the offer is given through the media.
- Under Public Issue, the securities are offered to public at large.
- Anyone in public can purchase these shares.
- They are of 2 types IPO FPO

Initial Public Offering:

- It is an offering of either a fresh issue of securities or an offer for sale of existing securities or both by an unlisted company for the first time to the public.
- Any company whether a new, young company or an old company which decides to be listed on an exchange and hence goes public.

Follow-on /Further Public Offer:

- FPO is used by companies to diversify their equity base.
- A follow-on public offering (FPO) is an offering of either a fresh issue of securities or an offer for sale to the public by an already listed company through an offer document.
- Investors participating in these offerings take informed decisions based on its track record and performance.

E-IPO:

- A company proposing to issue capital to the public through the on-line system of the stock exchange is called as e-IPO.
- The on-line issue of shares is carried out through an electronic network of the stock exchanges.
- The issuer company enters into an agreement with stock exchanges having system for an on-line offer and has to appoint brokers and registrars having connectivity through stock exchange.
- This system reduces the time taken for the issue process and securities get listed within 15, thereby enabling faster access to funds. The allotment of securities should be made within 15 days (closure of the issue).
- In case of failure the penalty rate is 15%.

Offer for Sale:

- Under this method securities are not issued directly to the public.
- The securities are offered for sale through intermediaries like issuing house or stock brokers.
- The company sells securities to broker at an agreed price who in turn resell them to the investing public.

Private Placement:

- The direct sale of securities by a company to some select people or to institutional investors is called private placement.
- No prospectus is issued in private placement.
- Private placement covers equity shares, preference shares, and debentures.

- It offers access to capital more quickly than the public issue and is quite inexpensive on account of the absence of various issue related expenses.

Qualified Institutional Placement:

QIP is an issue of equity shares or securities convertible into equity shares by a listed company to qualified institutional buyers only.

Right Issue:

Right Issue' means offering shares to existing members in proportion to their existing shareholding.

The "right" to buy shares is given to the existing shareholders at discounted price.

The right is given in the form of an offer to existing shareholders to subscribe to a proportionate number of fresh, extra shares at a pre-determined price.

Benefits of primary market

- Primary markets are considered as safer for investment as there are lower chances of manipulation of prices.
- There is no requirement to time the market and all the investors get the shares at the same price.
- The primary market is considered secure as primary research data is collected by the organisation which deploys the research.
- The company which issues the initial public offer receives funds and issues new security certificates to its investors.

SECONDARY MARKET

The secondary market is also known as the stock market or stock exchange. It is a market for the purchase and sale of existing securities. It helps existing investors to disinvest and fresh investors to enter the market. It also provides liquidity and marketability to existing securities. It also contributes to economic growth by channelizing funds towards the most productive investments through the process of disinvestment and reinvestment. Securities are traded, cleared and settled within the regulatory framework prescribed by SEBI. Advances in information technology have made trading through stock exchanges accessible from anywhere in the country through trading terminals.

Features of Secondary Market

- Gives liquidity to all investors. Any seller in need of cash can easily sell the security due to the presence of various buyers.
- Very little time lag between any new news or information on the company and the stock price reflecting that news. The secondary market quickly adjusts the price to any new development in the security.
- Lower transaction costs due to the high volume of transactions.
- Demand and supply economics in the market assist in price discovery.
- An alternative to saving.
- Secondary markets face heavy regulations from the government as they are a vital source of capital formation and liquidity for the companies and the investors. High regulations ensure the safety of the investor's money.

Types of Secondary Capital Market

1. **Stock exchange:**

   A stock exchange is an institution which provides a platform for buying and selling of existing securities. As a market, the stock exchange facilitates the exchange of a security (share, debenture etc.) into money and vice versa. Stock exchanges help companies raise finance, provide liquidity and safety of investment to the investors and enhance the credit worthiness of individual companies.

   According to Securities Contracts (Regulation) Act 1956, stock exchange means anybody of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying and selling or dealing in securities. National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) are examples of such platforms.

2. **Over the Counter market:**

   OTC market refers to the process where securities are traded in an informal way i.e. that is not listed on a formal exchange. Under this the securities that did not fulfil the requirements to have a listing on a standard market exchange.

It is a bilateral contract, where two parties are involved i.e. the investor and dealer. Stocks traded in OTC market are basically of smaller companies.

Exchange traded market: Exchange-traded market also known as auction market is a place where all the transactions are routed through a central source (exchange) that is completely responsible for being the intermediary that connects buyers and sellers.

Advantages of Secondary Market

- Investors can ease their liquidity problems in a secondary market conveniently. Like, an investor in need of liquid cash can sell the shares held quite easily as various buyers are present in the secondary market.
- Price adjustments of securities in a secondary market takes place within a short span in tune with the availability of new information about the company.
- Investor's funds remain relatively safe due to heavy regulations governing a secondary stock market.
- Mobilisation of savings becomes easier as investors' money is held in the form of securities.

Basis	**Primary Market**	**Secondary Market**
Securities	Only new securities are traded	Existing securities are traded
Price of Securities	Prices of securities are determined by the management of the company.	Prices are determined by the forces by the demand and supply of the securities.
Purchase and Sale	Securities are sold to investors directly by the company or through intermediary.	Investors exchange ownership of securities.
Place of Market	There is no fixed geographical location.	Located at specified places.
Medium	Only buying of securities takes place.	Both buying and selling of securities can take place.