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Research Article

TO STUDY THE OPERATING PROCEDURES OF STOCK MARKETS AND SUGGEST STRATEGIES FOR TRANSPARENCY IN TRANSACTIONS

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A R T I C L E I N F O

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A B S T R A C T

Stock exchange provides the stock brokers to trade the company stocks and other securities the stock can be bought or sold provided the condition that it is listed on an exchange. Therefore it is the meeting place for the stock buyers and sellers. Indian main stock exchanges are the Bombay Stock Exchange and National Stock Exchange. The study deals with the basic principles of stock market how it functions what are the key words and principles used in stock market and how BSE and NSE formed what standards they use to deal with the global stock market and also discussed what stock market can offer to investors and the risks involved in stock markets, different types of markets available for investors, what are stocks, bonds, cod, mutual funds, what are stock market trading strategies, derivatives markets and their products, learnt NIFTY, BSE Sensex and also discussed a case study about the stock market crash in 2008 which has brought crisis globally and what are the factors that caused for the stock market to crash and what are the sources of failures and the persons responsible for this market crash 2008 and had a brief look into the stock market crash how and where the crisis started what factors led to the crisis and the effect of the crisis what are the firms that suffered, collapsed and went to bankrupt and what initiatives does the nation took in order to cure this market crash and rescue the firms that were about to go bankrupt. Factors responsible for Indian stock market fall has also been scrutinized which gives the overall view for the stock market crash in 2008.

INTRODUCTION

Profile of the Company

About the Organization

Emkay Global Financial Services Ltd was established on January 25, 1995 with the aim of ensuring success of its clients, employees, partners, investors and society at large. The company provides solutions and services for the financial needs of the customers. Working towards its mission and vision and trying to make every person's life successful, it has been declared as the best analyst of the year by India's Institutional Awards (2014). Over a period of 20 years the numbers themselves speak for its success. It has grown its customer base to more than 100000 High Net worth Individuals (HNIs), Corporate, and NRIs & Retail clients.

The company provides a variety of services to its customer's right from managing their portfolio to giving investment advices to commodity trading and insurance as well as equity trading.

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Business area of the company

- Equity and derivatives broking (retail and institutional)
- Equity research
- Corporate advisory
- Depository services
- Wealth management and portfolio management services.
- Insurance broking
- Investment banking
- Commodities research and broking
- E-broking
- Mutual fund distribution
- IPO's

Emkay Fin cap Limited (EFL), a 100 per cent subsidiary of EMKAY, is a RBI registered Non Deposit taking NBFC. The firm was incorporated on May 16, 2005 for carrying out share financing activities. The company went public on February 14, 2006.

Emkay Commotrade Limited (ECL), a 100 per cent subsidiary of EMKAY, was incorporated on January 5, 2006 and carries out commodity broking business. ECL is a member of the two popular commodity exchanges - MCX Commodity Exchange and NCDEX Commodity Exchange. ECL offers trading in many commodities such as bullion (gold, silver), energy (crude oil, natural gas), metals, food grains (rice, maize), spices, oil and oil seeds and others.

Stock exchange provides the subscriber the option for the declaring and retrieval of securities which includes the payment of income and dividends. The stock exchange is done by members and stock broker do have a seat on the exchange.

Emkay Insurance Brokers Limited (EIBL), a 100 per cent subsidiary of EMKAY, was incorporated on March 8, 2007 as a direct Insurance broker as per the IRDA regulations. Focusing on life and non-life businesses, the company aims to benefit from its huge existing retail client base and existing corporate relationships.

Emkay Investment Managers Ltd (EIML), a 100 percent subsidiary of EMKAY was established to carry on the business of Portfolio Management Services. The company aims to serve the existing and potential PMS clients more effectively.

Mission Statement

“To provide our clients with secure, customized & comprehensive financial solutions to achieve sustained growth”

Vision Statement

- To be fair, empathetic and responsive in serving our clients.
- To respect and reinforce our fellow employees and the power of teamwork.
- To strive relentlessly to improve what we do and how we do it.
- To always earn and be worthy of our customers' trust

Introduction

Today most of the people are interested in investment opportunities and before analysing the stock market we will know some basic terms that will help in our further study to understand in a better way

1. ***Stock Market****:* stock market is a place containing both listed and unlisted securities where trading on company stock takes place.
2. ***Stock Exchange****:* stock exchanges compared to stock market is an organized market place where members of the organization come together for trading their stocks or other securities. The subscriber of firm/enterprise/organization who trade their stocks can be the representative of customers or principals of their own accounts.

Stock Market in India: Indian stock market we see today is one of the oldest stock market in Asia. If we rewind the time and go back to 18th century where we were under the British rule in which trading was done by the east India company which is used to transact loan securities. The trading in 1830’s consists of trading shares in bank, corporate stocks and cotton presses took place in Bombay. Although trading was broad in India but the employees or workers were hardly half a dozen which is 6 members during 1840 and 1850.The trading in India was done not only by east India company but an informal group is formed containing 22 stock brokers who started trading business under a ficus benghalensis which is also known as banyan tree which is in front of the town hall of Bombay from mid of 1850’s, who each invested a amount of rupee 1. In 1860’s the exchange has developed and proliferated with 60 brokers. The fact behind this proliferation of share mania in India began with American civil war broke and when the supply of cotton stopped from U.S. to Europe stopped. This market mania didn’t stopped and the exchange which started under the banyan tree has increased to 250. And finally with this increase in employees or brokers the informal group of stockbrokers who started under a banyan tree and made this journey into a great success which they lined up themselves as the native share and stockbroker’s association which is established in 1875, was formally known in today’s world as Bombay Stock Exchange (BSE). BSE was shifted to a building which is old near the town hall. In 1928 the BSE which now stands at the present address was acquired and was constructed and stayed in and performing all the functions from there since 1930.The leading stockbroker of that time is permchand roychand which he aided in display of established practices, protocols, and strategy for trading of stocks in Bombay Stock Exchange and these principles are still followed in BSE. In Mumbai most stock broking firms are family run firms or enterprises, and named these firms after the heads of the family.The following checklist is some of the initial members of the exchange who are still into this present world of business running successfully:

DSP a joint venture partner with Merrill lynch which we know in present world at that time it is known as D S Prabhudas &cmp.

JM finance ltd at that time addressed as Jamnadas morarjee.

The Government of India recognized the Bombay Stock Exchange which is also known as BSE based on securities contracts Act in 1956. It is the first stock exchange in the country.The phase shift period in the history of the BSE took place after 1992 with the major scandal in market manipulation involving a BSE member Harshad Mehta, due to his actions BSE responded to calls for rectification with intransigence. The drawback by the BSE helped transition of the government, which bucked up the creation of National Stock Exchange also known in short term as NSE which created an e-marketplace. National Stock Exchange started its e-trading (electronic trading) on 4th November 1994. Formation of NSE within a year has overtaken the BSE turnover. Although seeing its competitor growth BSE immediately changed to computerized it couldn't be able to face the competitor or win with NSE spot market turnover. The second decisive defeat faced by BSE after two years following the first scandal is failure of counter action by NSE which launched the equity derivative trading. BSE used political influence to counter attack NSE through SEBI chairman by intercepting equity derivatives trading. Although at initial stage the interception of equity derivatives trading by BSE and chairman is successful by delaying it for five years but due to shift of the spot market to rolling settlement which came into market between 2000 and 2001 helped NSE gain the equity derivatives trading nearly 100% where BSE was forced to get second place in equity derivatives trading. Today between NSE AND BSE, NSE has roughly equity spot turnover of 66% and in the segment of equity derivatives turnover of roughly 100%

So stock exchange can be explained in simple words as a trading platform which provides the facility for buyers and sellers to meet and transact in securities.

Capital Market: capital market can be defined as the issuing instruments such as bonds, stocks for long term and medium term and capital term can be classified into two types which we will be discussing in detail as follows

Primary Market

Today we see most of the companies are private which are started by their promoters but for the business to run in long term the promoters capital or acquired capital from banks or financial institutions is not sufficient. In this situation the firm/corporate and the government in order to raise the long term funds looks at the primary market which is of issuing securities comprising issuing debts or equity.In a primary market the issuing securities comprising of debts or equity which may be issued at face value, or at premium or at discount. Issuing securities through above three methods can be discussed in detail as below

Face Value: face value can be defined as the authentic cost of the security which is displayed in the certificate/instrument. We generally have in equity shares face value which can be defined as the par value of a security stated by the issuer of Rs5, Rs1, Rs10 and Rs100and doesn't have much connection with the original market price. When the company plans to issue securities, they may have two options to offer at discount or to offer at premium.Let us know what is issuing at premium or issuing at discount really mean.

Premium: premium can be defined as when the security is proposed at a price higher than the face value.

Discount: discount can be defined as when the security is proposed at a price lower than the face value of the share.

Secondary Market

The investors in present world would not like to invest if there is no option to liquidate. The secondary market provides its investors a productive platform to trade those securities which was issued earlier/previously in primary market. To say it in simple words about how secondary market works is all those investors who are interested and apply for shares in an initial public offerings commonly referred as IPO may get the allotment or may not get allotment of share. If they get allotment of share then the investor is happy if they don't get allotment then for those investors they have an option that they can always procure the shares in the secondary market where sometimes they need to buy the shares at premium or discount.The secondary market trading is executed over the stock exchange. As we already discussed the definition of stock exchange in above as an organized market place where buyer/client/ customer/purchaser and seller/dealer/merchantcome together for trading their stocks or shares in an organized manner. The stock exchange do perform some essential functions which are listed below

1. It not only provides a trading platform to the investors but also provides the liquidity.
2. It also facilitates the classifying of securities.
3. The stock exchange provides registering of members who also include stock brokers and sub brokers also
4. The stock exchange is made and enforced by laws.
5. The stock exchange also has the feature of managing risk in securities negotiation or transactions.
6. It also have the option of providing indices in stock exchange.

The trading in India can be done through two prominent stock exchanges which we all know them as BSE & NSE.

1. ***Nse:*** NSE also known as national stock exchangeproviding the trading in the equity market together with the debt market was incorporated in the year 1992. National Stock Exchange gets the privilege of leadership position in the today's country scenario since high volumes take place on National Stock Exchange.
2. ***Bombay Stock Exchange:*** On the other side of the stock market in India BSE was formed in year 1875 and as we have discussed above in the history of stock market Bombay Stock Exchange is the ancient stock exchange in Asia continent. BSE is also equal competitor to NSE and it has emerged in to its current dignity as the premier stock exchange.

Bombay Stock Exchange

As we discussed in the history of stock market the Bombay stock exchange we see today was formed in the year 1875 in the name of the native shares and stock brokers association And it is older compared to the Tokyo stock exchange and hence it got to known as the ancient stock exchange in the entire Asia since Tokyo stock exchange established in 1878. The BSE took many shifts which started as independent non-profit making association of persons and had a transition by modifying itself into a demutualised and corporate body. This transition has expanded over the years into the present dignity which we said in above statement as the premier stock exchange in India. Bombay Stock Exchange under the securities regulations act was the only first stock exchange in India to acquire a permanent recognition in 1956 from the government of India.The Bombay Stock Exchange not only provides to investors the productive and transparent trading securities in market but also recognizes and ensures the redressal of their resentment whether against the organization or it can be on its own member-brokers. The Bombay Stock Exchange strives for educating and informing the investors by organizing education programmes which are investor friendly and making accessible informative inputs to the investors.

National Stock Exchange

The NSE is India's dominant stock exchange present in 364 cities and towns over the country. National Stock Exchangewas build up by leading institutions to implement a modernized, fully automated screen based trading system. National Stock Exchange establishment has provided to its investors transparency, speed, safety, efficiency and market integrity. National Stock Exchange has played a key role in improving the Indian securities market by ways of microstructure, effective market practices, and trading volumes. Using to days information technology the National Stock Exchange has furnished efficient, transparent trading, clearing and settlement mechanism, and witnessed several innovations in the products and services.

National Stock Exchange established with the following objectives:

1. NSE provides a nationwide trading facility for equities, debt instruments.
2. NSE ensures equal access to all its investors present in any country over a proper communication network
3. NSE utilizes the present electronic trading systems by providing fair, efficient and transparent securities
4. It facilitates the shorter settlement cycles and settlements in the book entry system.
5. NSE is able to meet the present international standards of securities market.

The criteria for the industry benchmarks was set by the NSE in terms of market practices and technologies and these criteria are being followed by other market participants. National Stock Exchange is not only assist the progress of the market but also it's impulse that directs many industries in the direction of new scope and greater opportunities.Before the establishment of NSE any investor who wants to transact in the securities who has no possibility to trade at nearest exchange had to go through many steps through a series of brokers for the appropriate exchange and still there is a great chance of uncertainty and high transaction costs in this hectic process. One of the main objectives when the NSE was established is to facilitate to all the investors the availability and access to NSE securities market.This objective was made real to an investor by NSE for which investors have the chance irrespective of their location to access the same market and order book at the same price wherever they are and provide to all the investors the same cost. National Stock Exchange used the most advanced telecommunication technology to facilitate the above functions to the investors by using this technology provided by the NSE to trade remotely from their offices irrespective of the country and NSE in order to provide smooth flow of this communication NSE trading terminals are present in 363 cities present in all over India.Many financial institutions, banks, insurance companies and many other intermediaries of finance have promoted National Stock Exchange.In India National Stock Exchange is the first to start the demutualised stock exchanges, where the possession and administration of the exchange is absolutely dissolute from the right to trade on it. Though the impulse for its formation came from policy makers and it has been built as a public limited company possessed by the major institutional investors in the country.

Security Measures & Operational Features of Bse And Nse

The stock exchanges have developed since its establishment has developed itself a lot. They aspire to make available to the investors and traders a better transparency, genuine settlement cycle, honest transaction and they also try to reduce and solve investor grievances.

Operational Features

Market Timings: In stock exchange trading on shares or equities segment happens on all days of the week excluding weekends. The timings of the market of the shares/ equities segment are:

Market opening time: 09:55 am
Market closing time: 15:30 hours.
Post-closing session is held always between
15:50 hours to 16:00 hours.

Automated Trading System: In present situation our country has a most sophisticated trading system with the help of advanced technology which is a fully automated screen based trading system. The advantage of this automated based trading system is that it works on the principle of an order driven rather than the quote driven system. In India the two stock exchanges we know are BSE and NSE where NSE operates on the National Exchange for Automated Trading also known as NEAT system where as the BSE operated on the BSE Online Trading system also known as BOLT system.

Order Management in Automated Trading System: In India the trading system furnishes perfect flexibility to the members in kinds of orders that can be placed by them. These orders are primarily numbered and time stamped on the receipt and then it is refined for potential matches immediately.

In the stock market every transaction or order has a distinctive order number and a unique time stamp on it. Then they are compared and if a match is not found then the orders that aren't matched are stored in different books. Orders are primarily stored in the following sequence based on the price-time priority in various books.

Best Price, within Price, By Time Priority

Price priority can be best explained by following example in which if we have two orders and are entered into the system, then the order that is having the best price gets the higher priority. Time priority can be explained as if the two orders that are entered into the system have prices which are same then in this situation we cannot use best price so we take decision based on the order that is entered first gets the highest priority in other words the order that is entered first or out of two orders the order which is having least time or earlier than other order gets the highest priority this is how time priority works.

Order matching Rules in Automated Trading System

In this trading system best buy order is matched with the best sell order. This can be explained in more detail where an order may match partially with another order resulting in multiple trades. In order to execute the order matching we see the order with the highest price and we can call this as the best buy order because the system views all buy orders available from the point of a seller because a seller would always want to sell his orders at the highest possible price so the best buy order is the order with the highest price. Whereas the best sell order is the one with the least or lowest price because the system views all the sell orders available from the point of a buyers in the market as a buyer would always want to buy at least possible price so that he can save his moneyand be profited by buying at low price so it is called as best sell order which is the order with the lowest price.

Order Conditions in Automated Trading System: Members of the trading can get in different types of orders which builds upon the requirements of his/her. These conditions can be largely classified into 3 categories.

1. Time Related Condition.
2. Price Related Condition.
3. Quantity Related Condition.

Time Conditions

Day Order: It can be defined as when the order is entered it is valid for the day on which the order is entered. The order gets cancelled when the order is not matched during the day and the cancellation is done automatically at the end of the trading day which is around 3:30 p.m. to 4:00 p.m.

GTC Order (Good Till Cancelled): The only difference between the Day Order and G.T.C. order is that it remains in the system until or unless is cancelled by the trading member. So from above difference G.T.C. Order has a competitive edge over Day Orderand also G.T.C. Order can be able to stretch trading days if the trading order doesn't get balanced/matched but the exchange discloses the maximal number of days a G.T.C. Order can remain in the system from time to time.

GTD (A Good Till Days/Date): GTD can be defined as the order which grants the trading member to cite the number of days/ at a particular date up to which the order can stay in the system and at the last day of the period which is priory mentioned by the trading member the order gets flushed away from the system. The number of days which is mentioned by the trading member on which the order is placed is counted and are inclusive of the day/date. In a GTD Order the maximum number of days in which an order can be there is notified by exchange.

IOC (An Immediate or Cancel)*:* IOC grants the trading member to buy/sell a security as fast as the order is liberated into the market and any unpaired/unmatched order is cancelled immediately.

Price Conditions

1. Limit Price/Order: while inserting the order in a system Limit Price/Order allows the price to be specified.
2. Market Price/Order: Buying or selling securities of an order at the perfect price obtainable at the time of entering the order.
3. Stop Loss Price/Order: The order which permits the trading member to place an order so that it gets triggered/activated only when the market price of the security reaches a verge/threshold value. Until the above process is done the order doesn't enter the market. A sell order in Stop Loss Price/Order gets triggered in the normal market when the last traded price falls below the trigger price of the order whereas for buy the last traded price should exceed the trigger price of the order in a normal market.

Quantity Conditions

Disclosed Quantity: This order grants the trading member to unveil only a part of the order quantity to the market. The Disclosed quantity cab be bitterly explained with an example an order which is of 1000 and using Disclosed quantity conditionof 200 which means that 200 will be visible to the market at a time only. After these 200 are traded then again another 200 is automatically discharged. The exchange always keeps changes the minimum disclosed quantity from time to time.

1. Minimum Fill: This order grants the trading member to specify the minimum amount of quantity so that an order should be filled. If we consider the above example of order of 1000 units for which here Minimum Fill is 200 then for each trade there should be minimum of at least 200 units. From above statement we can deduce that there will be maximum of 5 trades since (5*200=1000 units) or we can do a single trade of 1000 because our condition is atleast 200.
2. All or None Orders: This order grants the trading member to impose the condition in which only full or complete order should be matched against. In case the full order doesn't match it will stay in the books till matched or cancelled.

Market Segments

The exchange operations in market/equities segment operates the listed below sub segments:

Rolling Settlement

The rolling settlement functions as a trading period for each trading day and all the trades that are executed within a day are made settled based on the net constraints for the day. At the national stock exchange the trades which in rolling settlement are settled on T+2 basis which is on the 2nd working day so this T+2 is done excluding all the holidays, which include bank holidays, NSE holidays, Saturdays and Sundays.so from above one if trading takes place on Tuesday's trade is settled on Thursday.

Financial Investment Facts

When investors invest money into ambiguous, uncontrollable, unstable facets can be exceedingly risky this stock market trading can be compared with a lottery not completely but partly it is based on luck just what we do in a lottery. Many people who had little idea about the stock market make weak investment decisions based on luck factor as more have lost a huge amounts of money. It is responsibility of the investor to understand about the stock market and accept the risk factor associated when investing money into stock market.Each coin has two sides so does investment in stock market we have discussed it's disadvantages and now the brighter side of stock market to be precise the optimistic side can be if the investor has a good grip on the stock market knowledge and how it functions which results an intelligent decisions through which an investor can yield high capital gains, profits and security by following a particular strategy

Financial Investment Prospects

Shares of Stock

Most of the investors when they think of stock market the first thing which strikes their minds is their chance of investment is shares of stock in a company. The New York Stock Exchange does not permit the normal public to trade stock in it but rather it provides them an option to the public to trade through stockbrokers. So here the role of stockbrokers will be to buy or sell the stock acting as the customer's representative charging a commission to a customer for using the stockbroker service and they often give valuable investment advice to the customers based on their tacit knowledge or experience they gained in stock market.As we know each coin has two sides so do investment in stocks which is having a risk part on other side where it is tough for an investor to predict the return on investment since price of the stock is determined or relies on the financial success of the company, the demand for its stock by the investors. Investors can have an option to have their stock portfolio which is the investor's collection of stocks which is always managed by his stockbroker so that the hardship and duty from the point of the investor is being removed with the help of stock broker tacit knowledge. The investors trust their stockbroker while investing their money on behalf of them by the stockbroker into a share market and relinquishing a part of money as commission to the stockbroker as a part of his services and his strategies in making a successful investment decisions. Because of stock market fluctuations and uncertainty many investors with a throng of opportunities for hefty profits.

Bonds

Bonds are a type of mortgage allocated by the holder, to a corporation or the individual usually referred to as the issuer. The mortgage or loan agreement comprises the stated time, after which the bond will be mature or said to mature. Before the bond matures a specified amount of interest is combined half yearly during that time because after the bond matures there will be no further interest which will be accrued. When the bond has been matured the holder of the bond can cash the bond and he can restore the principle he invested when bond was taken plus the combined interest giving him the profit which the interest he gained and note that the holder cannot be able to cash the bond before it expires or matures if he wanted to cash the bond then he should be paying the penalty for that which most of the times results an overall loss for the investor for trying to cash the bond before the mature period or expiry period of the bond.

Unlike the stock markets the competitive edge that the bonds have is their guaranteed Return of Investment and so they are the reliable assets in an investor's portfolio. Investors have an option to invest their money in the bond funds through a stock broker who will be acting as third party invests the investor's money in many companies. The investor acquires a part of earnings besides the principle due to taking a stake in the principal investments made on behalf of the investor by the stockbroker the main reason why bonds are safe for investors is because of its stability, guaranteed return on investment and additionally they doesn't get affected by any stock market and they are famous for long term investments, and during Ambiguous financial times.

Certificate of Deposit

Very much similar to bonds we have seen above certificate of deposit also referred or known to investors as COD are investments made by the investor in a bank or credit unions who practically loans a bank a principle amount on which bank assures to pay interest since no person would like to give money to other without expecting any profit in return and in this COD the investor invests in the form of a long term saving account. Since we already mentioned that it functions likely how a bond functions so in COD when it matures the investor collects not only the principle amount invested by him at that time and also the interest which is paid by the bank. COD have been known to be virtually risk free, long term investment opportunity. Some COD's are prone to the inflation and variationof interest rates they are prone because of investments done in certificates of deposit are made over many years.

Mutual Funds

Mutual funds are a type of investment done by an investor in a fund and this mutual funds is administered under the lead of fund manager which is invested in many different small investment. So the duty of the fund manager is to generate a return for this fund principle out of which a part of it will be paid to investors by trading these small investments regularly. Mutual funds will act as amedium risk compared to Certificate of Deposit since their dependence on stock market but these mutual funds can be an easy chance for a rookie investor.

Stock Market Trading Strategies

Day Trading

Day trading as the name suggests it is the speed based investment approach of buying and selling a stock within the same day. Day Trading mostly depends on quick decision based from the investors since the investor has to buy and sell it on same day that too profit oriented so the decisions he take should obviously be quick effective oriented one and so day trading completely depend upon the daily fluctuation of stock values. So every investor always have a strategy in their minds to ideally buy a stock at the lowest price for that day and also sell it at the highest price of that day and earn the highest difference which is profit for that entire trading day. Investors who trade based on day trading strategy is called as day traders so the day traders don't care about which company they are buying stock in since their motto is earning high profit so they see only the stock promising growth for that day only. Because stock market known for high fluctuations and also day trading relies on stock market fluctuation and as we said each coin has two faces so does the day trading which can yield huge profit as well as huge losses. Those who are earning huge profits or returns on day trading requires the well experience and also readily to take risk. Present technology has provided this world the internet with which the investors can do day trading from their homes with just a click.

Swing Trading

Unlike day trading swing trading is the procedure of trading price variations at the peaks over a time period of few days or may be few weeks unlike day trading which is fixed to one day. Since swing trading takes place for a few days to few weeks so for implementing this strategy the investor should be more focussed and should keep an eagle eye of the company that the investor is trying to invest in. So the investor should see when it is the best time to sell and buy a stock taking the consideration of market fluctuation so that the investor can be highly profited.

Swing trading when compared to day trading is less risky since day trading takes into consideration of only current growth and fluctuation.

Equity Derivatives

Basics of Derivatives

Derivatives as the name suggests is an agreement whose value we get from the value of some other underlying asset. Derivatives can deal big range of underlying assets which includes the following below

1. Metals which can be gold, silver, etc.
2. Energy resources which can be oil, natural gas, etc.
3. It also deals with agricultural commodities such as coffee, cotton, etc.
4. Financial assets like shares, bonds and also deals in foreign exchange

Significance of Derivatives

1. Based on real valuations and expectations derivatives market aids in enhancing price discovery.
2. It helps in shifting of risky trades from unorganized market to a safe organized ones so that the derivatives market can provide financial system to a strong stability.

Factors Influencing the Growth of Derivative Market Globally

Derivatives market has seen a prodigious growth since 4 decades. A lot number of derivatives contracts have been launched at the exchanges. With the experience of the stock market and how future derivatives work we can define some factors which drive the growth of financial derivatives are

1. Increased variations in the underlying assets in financial market.
2. Inclusion of financial markets globally
3. Reduction of transaction costs with the aid of latest technology in communications.
4. Perceiving of market participants on refined risk management tools to manage risk

Products in Derivatives Market

There are different types of products in a derivatives market which are classified as

Forwards

Forwards are the obligated agreement done between two parties to buy/sell an underlying asset at a predefined future date for an appropriate price which is predetermined on the date which the contract has been made and when the contract is made both the parties should be committed to honour the transaction regardless of any situation or price of the underlying asset at the time of honouring the transaction. Since the transaction is between the two people or two parties the conditions are customized. These are known as over the counter contracts.

Futures

Futures are identical in the way the forwards functions the only difference between the forwards and futures is that in futures the contract is made through a coordinated and organized exchange instead of doing negotiation between two parties.

Options

An options is the agreement that gives the right but not the obligation to buy or sell the underlying asset here the buyer of options pays the premium and buys the right whereas the seller of option receives the premium paid by the buyer with the obligation to sell/buy the underlying asset in the options the buyer can exercise his right or he can leave it there is no obligation to honour the contract but when the buyer exercise the contract the seller is obliged and should follow the contract.

Swaps

Swap can be defined as the derivatives in which the two counter party's transfer the cash flows of one party's to other party's financial instruments. These swaps can be of stock indices, interest rates, foreign currency exchange rates and even commodities prices.

Key Definitions In Stock Market

A stock index acts as an indicator of performance of complete market or to a unique sector if wanted. The stock index will play as a benchmark for portfolio performance

Major Indices in India

The two stock exchanges we know are BSE and NSE of which few popular indices used are

For Bombay Stock Exchange or BSE

1. BSE Sensex
2. BSE Midcap
3. BSE 100
4. BSE 200
5. BSE 500

For National Stock Exchange

1. CNX Nifty
2. CNX Nifty Junior
3. CNX Defty
4. CNX Midcap
5. CNX 500
6. SX 40

Out of these the most common we hear and see all the times are BSE SENSEX, CNX NIFTY

Nifty

Nifty to define this in simple words it consists of 50 stocks. The fifty stocks which were mostly preferred by investors. Companies which were in this nifty group are selected on the basis of their earnings growth and high p/e ratios. So now the nifty can be defined as an index which is gauged from the achievement of top stocks of different companies from different sectors so nifty generally consists 50 companies from 24 unique sectors.

IISL owns nifty, IISL which is a joint venture of NSE and CRISIL and CRISIL which is a subsidiary of S&P and so the nifty is called as S&P CNX NIFTY.

Bse Sensex

BSE SENSEX is the standard index of BSE which consists of 30 largest and most actively tradedstocks on the BSE.

Spot Price

Spot price can be defined as the current market price at which an asset is bought or sold for immediate payment and delivery. These are often used in relation to pricing of future securities. A security's spot price is regarded as explicit value of that security at any given time in the market place.

LITERATURE REVIEW

The stock market crash 2008 which has made a global impact has been criticized by many authors and many research scholars gave their valuable insights of what made the stock market crisis in 2008 which resulted a huge damage.According to Bianco who has done research in subprime lending crisis which was the root cause of the stock market crash in 2008 has shared his valuable tacit knowledge which he says that reasons for the fall of stock market came with number of factors in which subprime mortgage has played a major part. The reasons for the mortgage crisis to happen are

The rise of subprime lending

- Declining risk premiums
- New kind of lender emerges.
- Mortgage brokers and underwriters
- Securitization
- Credit Rating Agencies

From the above reasons it resulted the collapse of the subprime mortgage industry in early 2007 which impacted the Dow Jones stock market. This information has given me a lot of knowledge and deep insights into the stock market crash which helped for making my analysis part.According to Henry Antila who has done research on the stock market crash 2008 has given some valuable insights into the companies which affected due to subprime crisis that led to stock market crash and also the federal government measures taken to save those companies from going to bankrupt. Henry Antila says the crash of 2008 was happened due to subprime mortgages and he mentioned two companies which are Federal National Mortgage Association and Federal Home loan Mortgage Corporation which are popularly known as Fanny Mae and Freddie Mac which had quarantined peoples loans for worth 6 trillion dollars. When the subprime mortgage crisis started they were in trouble and the Federal Housing Agency helped these companies and took over these companies by Federal Government, Bank Of America played a key role in saving some banks like Meryll Lynch through which this information gave me a deep insight into the stock market crash which led to the collapse of companies. According to Karan Walia, Rimpi Walia, Monika Jain who provided a insights into the foreign institution investment also known as FII's on stock markets and their role in Indian stock market which played a huge role in sharing the effect of U.S. stock market crisis they have given their research knowledge of FII's and how they function and their influence in Indian market through which he has explained the relationship that exists between the Foreign Institution Investment and stock market and also has shown the volatility of BSE Sensex due to FIIS and also shown the relative stock movement by Foreign Institutional Investment during the stock market and also has proven that there is an close correlation between the BSE Sensex and FII's volatility through which it helped in backing up my statement of FII's impact on Indian stock market during the U.S. stock market crisis. Karan Walia supported this theory from the most eminent investment banking Stanley Morgan which has examined that FIIs have played a key role in making up India's forex reserves and Morgan Stanley has also examined and found that the FII influence short term market movements during bear markets. Through this facts this study got a source for Indian stock market crash and it is able to establish the linkage to FII's and Indian stock market.

Objectives of the Study

1. To understand basic concepts of stock market.
2. To understand how stock market functions.
3. To understand how stock market crashed.
4. To analyse the reasons for the crash in 2008.

Research Design

This research involves what are stock markets and discussing their basic terms and the research has been done on the stock market crash 2008 where this study has scrutinized the various factors that led to the stock market crash and reviewed many authentic sources and generated a report that discusses the detailed study of how stock market crash has affected globally and also it analysed the collapse of many companies, what rescue factors did the country took to reduce the impact of stock market crash.

Nature of Data

The nature of data contains the authentic facts and also collected from many eminent economists and authors who wrote about the stock market crash.

Data Collection Methods

Primary Sources

The opinions of the company employees has been recorded on the topic of reasons for stock market crash and also gave their valuable tacit knowledge about the stock market and its functions has helped this study become more valuable that helped in the analysis part of the stock market crash 2008.

Secondary Sources

1. Internet Sources
2. Research Papers.
3. E-books related to stock market crash.

1Stock Market Crash 2008

Facts

2008 it is the year which the world never forgets and it is the black day for the investors and for the stock markets it is the financial crisis of the world economy, markets over the globe has seen a steep fall of the S&P, NASDAQ and Dow Jones. In this crisis even the Indian stock market also suffered the economy the biggest companies that were hit were the DLF, Ranbaxy laboratories, Hindalco Industries, Tata industries, Reliance industries and Mahindra & Mahindra.
Disaster of stock market in the year 2006-2009

May 18th 2006

There is a fall of 826 points reasons for which there is a heavy selling by FII, retail investors and weakness in global markets.

April 2nd 2007

On this day Sensex opened with large gap of 260 points reason for which the Reserve Bank of India made a decision seeing the crisis to hike cash reserve ratio and repo rate. The Sensex ended with a loss of 617 points.

October 18th 2007

On this day the index slipped into negative zone due to the reason that the intensity of selling increased towards the closing bell and the Sensex ended with a loss of 717 points and nifty lost 208 points.

November 21st 2007

On this day the Sensex ended with a loss of 678 points and nifty ended with a loss of 220 points.

December 17th 2007

A huge round of selling in the late noon saw the index down by 856 points from the day's open.

January 21st 2008

Biggest fall of 1408 points reason for this fall in Indian stock FE was the global recession fear with all losses over all international exchanges.

January 22nd 2008

Indian stock market experienced a fall of again 875 points trading at the Bombay Stock Exchange was suspended for one hour due to the reason of Sensex crashed to a low of 15,576.30 within just minutes of opening, since it over crossed the circuit limit of 10 percent.The reason for this occurrence is global recession fear, extending losses after January 21st.

February 11th 2008

In this month there is a fall of 834 points at 16,631 Sensex. Reason for this fall is due to poor international sentiments and recession fear.

March 3rd 2008

There is an observed fall of 900 points in this month reasons for this fall was due to U.S. recession and budgetary policy concerns.

March 17th 2008

There is a fall of 950 points on weak cues from overseas market reasons for which this fall is due to global factors of recession was slipping all across world markets.

October 10th 2008

There is a fall of 800 points reasons for which there is weak industrial data with poor financial performance from IT sector.

A couple of years ago Alan Greenspan who served as chairman of the federal reserve and who also steered the U.S. economy through crisis from 1987 crash to the 9/11 attack was a star player and also called as the oracle and maestro. But now he is perceived as the responsible person for the crisis of stock market in 2008. He is criticized for permitting the housing bubble to develop as an outcome of his low interest rates and inadequacy of regulation of mortgage lending. He backed sub-prime lendingand recommended strongly homebuyers to swap fixed rate mortgages for variable rate deals which ultimately left borrowers became incapable to pay when interest rates rose. He finally agreed in an October congressional hearing that he had made a mistake

Richard Severin Fuld

Nicknamed as "The gorilla" for his hard line style. He was the C.E.O. of Lehman for 14 years until the banks bankruptcy. The toxic debt which is in billions Lehman passed it to the investors in the form of bonds. In 2008 beginning Lehman's share value fall to 73% and the company was compelled to sell 6 billion dollars in assets. The reason for the fall of Lehman brothers was that they used a contentious accounting approach known as "Repo 105" to understate its liabilities to the tune of 50 billion dollars.

Repo 105

It is an accounting deception in which a company allocates a short term loan as a sale and later uses the cash proceeds as a sale to reduce its liabilities. The company can connect with the excess funds of other companies for short periods in exchange for collateral also known as a bonds. The company which borrows the fund will vow to payback the short term loan which it has taken from company along with the little interest and the collateral will not exchange hands. This is the chance through which the firm can record the incoming cash as a sale.

Ralph R. Cioffi and M. Tannin

Ralph Cioffi and M Tannin who co-managed the Bear Stearns high grade structured credit strategies fund and Bear Stearns high grade structured credit strategies enhanced leverage fund. These two hedge funds have collapsed and were the first ones to hit the stock market and origin of market crisis. These two hedge funds are under the Cioffi who was the senior portfolio manager and Tannin who was portfolio manager and chief operating officer for the funds. They misrepresented for which the funds had invested in securities backed by subprime mortgages. These two funds failed when the prices for collateralized debt obligations linked to home loans fell surrounded by increasing late payments by borrowers with poor credit.

The principal cause of the stock market crisis which happened in 2008 was because of sub- prime mortgage which happened in the United States. To understand what the sub-prime mortgage is in short and crisp sub-prime mortgage is lending money to the people even they are with bad credit ratings, bad credit means people who conflict to pay back the loans. United States were unprotected to these loans and which automatically riven to collapse of stock market. We feel surprised how by subprime mortgage led to collapse of stock market. This happened because companies were lending more money than they had in their own bank this is termed as debt to equity ratio. Because of this subprime mortgage it provoked a large decline in home prices which lead to mortgage default and force closures and the devaluation of housing related securities

Housing Bubble

The current mortgage meltdown actually started with the bursting of the United States housing “bubble” that initiated in 2001 and reached its crest in 2005. A housing bubble can be explained as an economic bubble that can occur in local or global real estate markets. Housing bubbles usually initiates with a rise in demand from which we can be able to view a graph shifting to the right in the demand curve, in which there is a limited supply which takes a good enough long time to increase. Speculators enter the market trusting that they can make profits through short term buying and selling through which by their actions the demand drives further. At some point of time demand decreases which the demand shifts left at the same time the supply increases resulting in steep drop in prices and which results the bursting of bubble.

Historical Low Interest Rates

Many of economists admit that the U.S. housing bubble was caused due to the historically low interest rates.In response to dot com bubble crash which happened in 2000 and the immediate recession that began in 2001, theFederal Reserve has reduced the interest rates from 6.5 percent to a minimum of 1 percent. This was the biggest reduce of interest rates on which the crisis has initiated and led to a heavy fall of stock market and Green Span who is the who is chairman of federal reserve agreed in 2007 that the reason for housing bubble to be formed and burst was fundamentally caused by the decline in real long term interest.

Between the years of 2004 and 2006 the Federal Reserve Board raised interest rates from 1 percent to 5.25 percent and it stopped raising rates from further since the fear that a quick downturn in the housing market could cripple the overall economy. Nouriel Roubini who is a New York economist felt that the Federal Reserve Board should have taken this decision earlier rather than doing it now at which the housing bubble is about to intensify.

Housing Market Correction

As the crisis is growing many economists predicted that there would be a housing market correction because of the reason of over valuation of homes in the midst of bubble period. These estimates lied in the range from a correction of few points to more than 50 percent from peak values.

Rise of Sub Prime Lending

The subprime borrowing was the crucial factor which led to the increase in home ownership rates and its derived demand for housing in the period of bubble years. The United States ownership rate heightened from 64 percent in 1994 to an all-time highest peak rate of 69.2 percent in 2004. The demand that create due to this helped fuel the rise of housing prices and which automatically follows the consumer spending. This created the unheard increase in home values of 124 percent between the years of 1996 to the year 2006. In this bubble formation since demand is high and there is rise in housing prices also the homeowners took an edge over the increased property values of their home to refinance their homes with lower interest rates and also take out second mortgages against the added value to the use for consumer spending. With the burst of housing bubble which automatically followed the high default rates on subprime.

The share of subprime mortgages to total originations has gained from 9 percent in 1996 to the record of 20 percent in 2006 which the bubble was formed and the demand was high. Subprime loans totalled a huge amount of 600 billion dollars in 2006 which accounts a rough figure of one fifth of the United States home loan market.

New Kind of Lender Emerges

Some economists also criticized that during the boom years there was more emergence of a new kind of specialized loan lender which added additional impact to the mortgage crisis and the lenders are not regulated as are traditional banks. In the midst of 1970’s traditional lenders carried approximately 60 percent of the mortgage compared. But at the today’s world and particularly at this time such lenders hold about 10 percent and the share held by the commercial banks had increased from virtually zero percent to give or take 40 percent of the market.

Risky Mortgage Products

The rise of unregulated lenders also brought the rise in the kinds of subprime mortgage consisting of adjustable rate loans, interest only loans and stated income loans. Stated income loans also called as no doc loans in which the borrower doesn’t need to provide a documentation to confirm the income stated on the application to finance home buying.

In this in order to attract buyers instead of its higher risk loan options like A.R.M. which is also termed as the Adjustable Rate Mortgages and interest only mortgages buyers were offered more offers and incentives by lenders.

DOWN PAYMENT ASSISTANCE

Programs such as seller funded down payment assistance programs also played a role in stock market crash by helping the borrowers during the boom years. During the bubble period choosing a down payment on a mortgage can benefit the two parties which one of them is home owner and the other is the mortgage provider. A down payment creates an quick equity for the new home owner since many families who doesn't have good income levels struggle saving sufficient money for a down payment and mortgage closing costs one of the ways in which these families the homeownership can be made real or affordable is by using down payment assistance through which it allows to obtain the money required for the down payment for homeownership through the channel of third parties such as relatives, employers and non-profit organisations. But it is also observed by the analysis's that federal housing administration also known as FHA insured homes that are bought with seller funded non-profit assistance were sold houses with about 2 to 3 percent more than comparable homes bought without any such assistance. The shocking fact that proves that this DPA has also been an ingredient in the crisis of stock market crash is that from the years 2000 to 2006 more than 650,000 buyers got their down payments via non-profits.

MORTGAGE BROKERS AND UNDERWRITERS

Mortgage brokers doesn't lend their own money, and there is also absolutely no interrelationship between the two of which one is loan performance and other is compensation for them but instead they have the advantage in the form of incentive for selling complex ARM's it's because they get commission in higher amounts on ARM's.

A study that has been conducted in 2004 has found a fact that the brokers created a 68 percent of all residential loans in the United States, with subprime loans and alt-A loans which accounted for over 42 percent of the volume. The mortgage bankers association has declared that brokers are profited from the home mortgage boom during the housing bubble period but they didn't do well enough to resolve whether borrowers could really repay the loans, their actions left the banks and also lenders with a devastating defaults.The role of mortgage underwriters specifies whether the risk of lending to a borrower under certain guidelines is tolerable or not. The terms that that are taken into consideration by mortgage underwriters fall under three categories which are credit, capacity and collateral.An automated underwriting generated about 40 percent of all subprime loans in the year 2007. Automated underwriting can be defined which has minimal documentation and much more quicker decisions which can be within 30 seconds least as opposed to the normal underwriter to generate a decision which takes a week.

SECURITIZATION

Securitization can be defined as a structured finance process in which the assets, receivables or any other financial instruments are acquired together and classified them into pools and offered as collateral for third party investment. Collateral is the property or other assets that a borrower gives to a lender in order to secure his loan. If the borrower denies making the promised loan payments, the lender can have the right to seize the collateral to compensate its losses. Because of the securitization the investor appetite for **MORTGAGE BACKED SECURITIES MBS**and the impulse of credit rating agencies to give ratings to MBS loans with a high risk of default could be introduced and the risk readily transferred to others.

←→IMPACT ON STOCK MARKETS

Dated as on July 19th 2007 the Dow Jones industrial average has been hit with a record high closing above 14000 for the first time. But these figures aren't remained the same for long time by August 15th 2007 the Dow Jones had dropped below 13000, and the S&P had reached into a negative territory. These similar drops happened in virtually every market in the world just like a virus.

←→UNITED STATES CRISIS SENDS GLOBAL STOCKS PLUNGING

The subprime mortgage crisis has damaged not only United States stock markets but also global stock markets as on date 21st January2008. Major economies experienced a fall in stock prices by more than 7 percent in Germany and India, 5.5 percent in Britain, 5.1 percent in China and 3.9 percent in Japan.

←→THE FINANCIAL CRISIS OF AMERICAN INTERNATIONAL GROUP

Dated on 16th September 2008 the giant insurance company known to United States as the American International Group also in short form popularly known as AIG ran out of money to be more precisely its credit rating was downgraded forcing it to raise capital to back its commitment this is the task that has made the American International Group more tough and as the bubble burst now the people who are looking at the books had come to know that they had magnified of subprime mortgage securities. The investment bank Lehman Brothers which had completely collapsed due to market crash and declared bankruptcy on the morning of 15th September, which led the stock market to fall and the counterparties to which Lehman owed money to withdraw their assets also from the remaining investment banks like J.P. Morgan and Goldman Sachs, and also to liquidate their holdings in securities issued by AIG. This is the reason that it is amounted to run on its reserves following which the share price of AIG dropped. The United states department of treasury and Federal Reserve Bank understood the situation of the AIG is facing and they also clearly got a view that if they don't react to the situation of AIG then the AIG is also going to follow Lehman brothers in going bankrupt unless some rescue plan should be made by the United States department of treasury and Federal Reserve Bank and also surprisingly there is no private entity large enough to purchase AIG, so the Federal government essentially took it over assuming over liabilities of over 80 billion dollars but these liabilities later grew up to 100 billion dollars. The government takeover of AIG became a huge government intervention into the markets which it has put 100 billion dollars into the private financial system in order to stabilize its functions and save the AIG.

Collapse of Eminent Companiesdue to Market Crisis

Lehman Brothers went bankrupt, Merrill Lynch, AIG, Freddie Mac, Fannie Mae, HBOS, Royal Bank of Scotland, Bradford and Bingley, Fortis, Hypo and alliance & Leicester these all companies cam closure of Bankruptcies and they were rescued.

Companies That Were Rescued In 2008 Market Crash

Merrill Lynch

Merrill Lynch with more than 15,000 brokers in number and a huge amount of 2.2 trillion dollars in the form of client assets Merrill lynch was the world's largest brokerage. It went to the top position by reforming the stock market taking Wall Street to Main Street. But due to the market crisis and the prime reason for this crisis being subprime mortgages Merrill Lynch also been affected severely by the market crash and in September 2008 the Merrill Lynch been failed to exist as a separate entity and it was acquired by Bank Of America

Freddie Mac and Fannie Mac

The bursting of the housing bubble and in 2006 and the jump in force closures that caused a great huge losses to Freddie Mac and Fannie Mae each of which basic core business is buys home loans from the lenders packs these loans together and sell them to the investors providing them the guarantee that loans will be repaid. When the Federal government took over the control of Freddie Mac and Fannie Mae mortgage finance companies took a bailout of 187.5 billion dollars and the government received the preferred stock in the companies that paid initially a 10% dividend in return for the bailout funds.

Banks

The Trouble Asset Relief Program which was the most publicized bailout was established for helping the flattering United States banking system. Treasury helped banks by injecting 250 billion dollars into banks both large and small in order to raise their capital and also to give support in running their business normally which they lend money to consumers and business. In return for what treasury has done banks offered treasury with stocks, warrants at which later the treasury sold at a profit.

Foreign Institutional Investors also in short from known as FII have gained a prominent role in Indian stock markets in the 21st century the FII's shown a real dynamism in stock markets in Sensex in terms of its highest peaks and lowest falls. So according to SEBI the FII can be defined as an institution formed outside the India which come up with investment in India in securities which under a condition that a domestic asset company or domestic portfolio manager who manages funds raised or brought from outside India for investment shall be deemed to be a foreign institutional investor

Investments by Fiis

There are two types of investments which are available for FII

Equity Investment

100 percent investments can be in equity or it can be up to 30 percent invested in debt which can be in the ratio of 70(equity instruments): 30(debt instruments). If the FII chooses to take equity then it can invest in following instruments

1. Securities in primary and as well as secondary market which includes shares which are unlisted, listed or to be listed on a recognized stock exchange in India which are either BSE or NSE.
2. Units of schemes floated by the Unit Trust of India
3. Warrants

100 Percent Debt

If the FII chooses this investment plan then the investor should make 100% investment in debt securities only and the options he can have is

1. Debentures
2. Bonds
3. Dated government securities
4. Treasury Bills
5. Other debt market instruments.

FII play a key role in Indian stock market why foreign investors are interested in India is due to the good return rates that our country gives. In debt segment there foreign funds invest they get a huge interest rate differences between our country and foreign debt market in which if investors invests in U.S. market he will get a maximum of 2.7 percent where as if he invests in India he can get as much as 9-10 percent interest here. Each coin has two faces so this is the bright side of our stock market attraction to the foreign investors but the other side is FII investment tends to be volatile which can give a huge loss to Indian stock market when they sell it because our Indian stock market cannot manage such huge selling pressure. This volatility can be explained with the destruction of the great Lehman Brothers investment bank which happened in 2008 when the company declared bankruptcy, the collapse of Lehman Brothers affected the Indian stock market which crashed from 21000 points to below 8000 points due to heavy selling by foreign institutional investors.

The below table shows NSDL FII net investment during the year 2007 and 2008 where in 2008 the stock market crashed and the effect of FII in India

CONCLUSION

The stock market crash which occurred in 2008 and which globally affected is due to the subprime mortgage crisis which led to stock market crash and we also saw the root causes for the subprime mortgages crisis are listed as below

- Mortgage Brokers
- Under Writers
- Record Low Interest Rates
- Over Valuation of Assets
- Emerging New Lenders
- Financing Through Variable Interest Rate
- Down Payment Assistance
- Selling Mortgage Backed Securities

These factors led to the formation of housing bubble which led to higher demand and limited supply and there was a housing boom till 2006 at which the housing started to burst in which many companies like Bear Stearns, Lehman Brothers, AIG and many more companies which suffered huge loss and some declared bankruptcy and some other are rescued and the housing bubble burst there were many credit defaults in subprime mortgage and due to which the crisis started and the stock market collapsed resulting investors in a huge losses. So the primary reasons and its root cause for the stock market crisis in 2008 has been identified and the firms that are affected with huge losses are also explained in order to prove how the stock market crash has done huge impact to the world economy

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