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BA Economics Honours | Semester 1 | Calicut University

Security Trading Practices

Course Code: ECO1FM105 • Module 1

Module I: Investment Environment, Markets and Instruments

Financial markets constitute the circulatory system of a modern economy, mobilizing household savings and efficiently channeling scarce capital into productive corporate enterprises and sovereign developmental projects. Understanding the architecture of primary and secondary markets, capital market instruments, and regulatory safeguards is fundamental to navigating contemporary securities trading.

Unit 1 & 2: Financial Markets and Instruments

The national financial market is structured into two interconnected divisions:

- **The Primary Market (New Issues Market):** The marketplace where corporate entities and governments create and issue brand new securities directly to the public for the first time to mobilize fresh capital. Primary issue modes include:
  - *Initial Public Offering (IPO):* An unlisted company offers shares to the general public for the first time, transitioning into a publicly traded corporation listed on stock exchanges. Issues are executed via **Book Building** (where investors bid within an announced price band, determining the final cut-off price based on demand) or *Fixed Price Issues*.
  - *Follow-on Public Offering (FPO):* A previously listed company issues additional shares to the public to finance expansion.
  - *Rights Issue:* Existing shareholders are offered the statutory privilege to purchase additional shares at a discounted subscription price in proportion to their existing holdings.
  - *Private Placement / Qualified Institutional Placement (QIP):* Selling securities directly to select institutional investors (banks, mutual funds, insurance companies) without public prospectus filings.
- **The Secondary Market (Stock Market):** The marketplace where previously issued securities are continuously traded between investors. The secondary market provides liquidity, continuous price discovery, and portfolio flexibility without altering the total capital stock of the issuing enterprise.

Secondary Market Financial Instruments

- **Equity Shares (Common Stock):** Represent fractional residual ownership in a corporation. Equity holders enjoy voting rights and receive variable dividends based on corporate profits, but bear the highest financial risk in corporate liquidation.
- **Preference Shares:** Hybrid securities enjoying preferential statutory rights over equity holders: a fixed dividend payout and priority in capital repayment upon corporate winding up, but typically carrying no voting rights.
- **Corporate Debentures / Bonds:** Long-term debt instruments where the corporate issuer promises regular contractual coupon interest payments and principal repayment at maturity.
- **Government Securities (G-Secs and T-Bills):** Sovereign debt obligations issued by the RBI on behalf of the Central and State Governments, carrying zero default credit risk (gilt-edged securities).
- **Financial Derivatives:** Contracts whose value is derived from an underlying asset (equities, indices, commodities, currencies), predominantly **Futures** and **Options**.

Unit 3: Major Institutional Agencies of the Secondary Market

The institutional framework of the Indian capital market is anchored by world-class regulatory and technological infrastructure:

- **Securities and Exchange Board of India (SEBI):** Established as a statutory regulatory body under the SEBI Act, 1992. SEBI exercises comprehensive oversight to protect investor interests, regulate stock exchanges, prevent insider trading and fraudulent trade practices, register market intermediaries (brokers, merchant bankers, mutual funds), and enforce corporate disclosure governance.
- **Stock Exchanges:** The two premier national electronic exchanges:
  - *Bombay Stock Exchange (BSE):* Established in 1875, Asia's oldest stock exchange, hosting over 5,000 listed companies. Its benchmark index is the **S&P BSE SENSEX** (comprising 30 fundamentally sound, large-cap, liquid stocks).
  - *National Stock Exchange (NSE):* Established in 1992 and operational in 1994, pioneering fully automated screen-based electronic trading in India. The world's largest derivatives exchange by contract volume. Its premier benchmark index is the **NIFTY 50** (representing 50 blue-chip stocks spanning 13 sectors of the Indian economy).
- **Depositories and Dematerialization:** Prior to 1996, shares existed in physical paper certificates, plagued by bad deliveries, forged certificates, and prolonged settlement delays. The Depositories Act, 1996 enabled **Dematerialization (Demat)**—converting physical share certificates into electronic records held in fiduciary depositories:
  - *National Securities Depository Limited (NSDL):* Promoted primarily by IDBI, UTI, and NSE.
  - *Central Depository Services (India) Limited (CDSL):* Promoted primarily by BSE, State Bank of India, and leading commercial banks.

  Retail investors access depositories through registered **Depository Participants (DPs)**, which include commercial banks and stockbroking firms. Settlement operates on a cutting-edge **T+1 Rolling Settlement cycle** (and optional T+0 for select large caps), where trade transactions settle on the business day following trade execution.

Unit 4 & 5: Market Participants and Trading Mechanics

Trading in secondary markets is driven by diverse investor classes:

- **Foreign Portfolio Investors (FPIs / FIIs):** Overseas institutional asset managers, sovereign wealth funds, and hedge funds registered with SEBI. FPI capital flows exert massive influence on Indian stock index movements and the exchange rate of the rupee.
- **Domestic Institutional Investors (DIIs):** Domestic mutual funds (AMCs), Life Insurance Corporation of India (LIC), pension funds (NPS, EPFO), and commercial banks. Systemic monthly inflows through Systematic Investment Plans (SIPs) by retail investors have empowered domestic mutual funds to provide a powerful countervailing stabilizing buffer against volatile FPI foreign sell-offs.
- **Retail Individual Investors:** High Net-worth Individuals (HNIs) and millions of individual citizens executing trades via mobile broking applications.

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

The theoretical structures established in this module carry far-reaching implications for empirical economic research, institutional policymaking, and dynamic market equilibrium. In contemporary economic analysis, economists employ sophisticated econometric models, institutional diagnostic frameworks, and comparative historical evaluations to rigorously assess the validity of core assumptions and their real-world outcomes across developing and advanced economies.

Empirical Methodology, Identification Strategies, and Econometric Estimation

Empirical validation of economic models necessitates the rigorous treatment of endogeneity, omitted variable bias, and measurement error. Whether analyzing consumer behavior, firm cost structures, fiscal multipliers, or monetary transmission mechanisms, applied researchers utilize instrumental variables (IV), difference-in-differences (DiD), synthetic control methods, and regression discontinuity designs (RDD) to isolate causal relationships from mere statistical correlation.

Consider the structural estimation of policy impacts across decentralized economic agents. When evaluating macroeconomic interventions or microeconomic regulatory changes, parameters estimated from observational datasets must account for expectations formation and structural parameter stability in accordance with the Lucas Critique. Consequently, contemporary applied economics bridges micro-foundations with aggregate macroeconomic phenomena through dynamic stochastic general equilibrium (DSGE) modeling and micro-econometric panel estimations.

Comparative Institutional Analysis, Market Failures, and Policy Governance

Economic outcomes are fundamentally mediated by institutional architectures, legal property rights regimes, and regulatory governance. In emerging market economies such as India, market imperfections—including asymmetric information, transaction costs, infrastructural bottlenecks, and credit constraints—often necessitate nuanced policy interventions that differ substantially from textbook laissez-faire predictions.

Analytical Dimension	Orthodox / Classical Perspective	Heterodox / Institutional Framework	Empirical Policy Manifestations in India
Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
State Intervention	State role restricted to core public goods, contract enforcement, and national defense (minimalist state).	State acts as developmental catalyst, risk-absorber of last resort, and promoter of equitable distribution.	Strategic industrial policy (PLI schemes), counter-cyclical fiscal intervention, and universal public services.
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	distribution is secondary to allocative efficiency.	historical wealth accumulation shape distribution.	human capital investments.
Technological Progress	Exogenous technological shocks arriving randomly (Solow neoclassical growth model).	Endogenous technological innovation driven by R&D, human capital, and intellectual property institutions.	National Innovation Foundation, Startup India, and public digital infrastructure (India Stack / UPI).

Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

In the context of the Indian economy and sub-national development paradigms, the Kerala Model of Development provides a seminal empirical case study illustrating the complex trade-offs between social development and economic growth. Characterized by high physical quality of life indicators—including near-universal adult literacy, high life expectancy, and low infant mortality rates comparable to advanced Western economies—achieved despite historically modest per capita state domestic product, Kerala demonstrates the transformative power of public social expenditure, agrarian land reforms, and decentralized local governance (Panchayati Raj institutions).

However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

Policy Synthesis and Analytical Evaluation

Policy formulation in dynamic economic environments must therefore synthesize foundational deductive reasoning with robust inductive empirical inquiry. Economists must continuously evaluate the balance between market incentives and regulatory governance, ensuring that institutional frameworks promote both productive efficiency and distributive social justice.

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