

Stock Exchange, Functions & Trading Procedure on a Stock Exchange

1 Mark Question

1. State any one function of stock exchange. (Delhi 2012)

Ans. It provides liquidity and marketability to existing securities.

3 Marks Question

2. 'Stock exchange not only contributes to the economic growth, but also performs many other functions'. Explain any three such functions. (AllIndia2014)

Ans. A stock exchange provides a platform for disinvestment and reinvestment of savings into most productive avenues stock. Thus leads to economic growth.

However, stock exchange performs following functions:

- (i) **Provides liquidity and marketability of existing securities** Stock exchange provides a ready and continuous market where securities are bought and sold. It gives investors the chance to disinvest or reinvest. Thus, regular dealing provides both liquidity and marketability to existing securities.
- (ii) **Pricing of securities** The stock exchange helps in determining the prices of various securities that reflect their real worth. It enables correct pricing of securities through the interplay of demand and supply.
- (iii) **Safety of transaction** The stock exchange is well regulated and its dealings are well defined according to the existing legal framework. This ensures that the investing public gets a safe and fair deal in the market.

4/5 Marks Questions

3. Explain the trading procedure on a stock exchange (Compartment 2014)

Ans. The procedure for purchase of and sale of securities in a stock exchange involves the following steps:

- (i) **Selection of a broker** The first step is to select a broker, who will buy/sell securities on behalf of the investor/speculator. Brokers may be individuals, partnership firms or corporate bodies. Selection of broker is compulsory as trading can only be done by SEBI registered brokers, who are members of a stock exchange.
- (ii) **Opening of a demat account with depository** Dematerialised (Demat) account refers to an account which an individual must open with the depository participant (banks, stock brokers) to trade in the listed securities in electronic form.

Depository is an institution/organisation which holds securities in electronic form, in which trading is to be done. At present there are two depositories in India

(a) NSDL (National Securities Depository Ltd.) and

(b) CDSL (Central Depository Services Ltd.)

Depository Participant (DP) maintain your securities account balance and intimates the account status from time to time.

(iii) **Placing the order** The next step is to place the order with the broker, which can be done through telephone, cell phone, e-mail, etc.

Instruction regarding which securities and how many securities are to be bought or sold should be clearly given to the broker.

(iv) **Executing the order** According to the instructions, the broker executes the order and buys or sells the required securities. The broker then issues a contract note. A copy of contract note specifies the name and the price of securities, names of parties, brokerage charges, etc., which is signed by the broker.

(vi) **Settlement** This is the last stage in the trading of securities done by brokers on behalf of their clients. The mode of settlement depends upon the nature of contract. Equity spot markets follow a T + 2 rolling settlement. This means a trade taking place on Monday gets settled by Wednesday. Trading times on stock exchange are between 9:55 am and 3:30 pm 1ST, from Monday to Friday. Each exchange has its own clearing house, which assumes all settlement risk.

4. Explain any four functions of stock exchange. (Delhi 2013)

or

Explain any four functions of stock exchange. (All India 2011)

or

List the functions of stock exchange and explain any two. (All India 2008)

or

Explain any four functions of stock exchange. (Delhi 2008; All India 2008)

Ans. Main functions of stock exchange are as follows:

(i) **Pricing of securities** The stock market helps to value the securities on the basis of demand and supply factors. Higher the demand for such securities, higher is their value. The valuation of securities is useful for investors, government and creditors.

(ii) **Contributes to economic growth** In stock exchange, securities of various companies are bought and sold. This process of disinvestment and reinvestment helps to invest in most productive investment proposal and this leads to capital formation and economic growth.

(iii) **Spreading of equity cult** Stock exchange encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating people about investment.

(iv) **Liquidity** The main function of stock market is to provide ready market for sale and purchase of securities which assures the investors that their investment can be converted into cash whenever they want. The investors can invest in long-term investment projects, as because of stock exchange they can convert it into short-term and medium-term.

