CAPITAL MARKET OPERATIONS, PLAYERS, PRODUCTS, EFFICIENCY, INDEX ETC

A PAPER PRESENTED

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Outline

- What is Capital Market
- Types of Market (Primary & Secondary)
- Products Offered
- Products offered and product development in the Capital Market
  - Shares, bonds, debentures; etc
- Participants and roles in the Capital market
  - SEC, Stock Exchange, Stock brokers, Issuing Houses, Jobbers, Registrars, Institute of stockbrokers; etc.
- Methods of Accessing the Capital Market
  - Offer by Introduction, Offer for subscription, Right issue, Bonuses, Offer for sale, Private Placement, Share split, construction, reconstruction and consolidation
- Determining Appropriate Market Price for a Security
1.0 THE CAPITAL MARKET

1.1 It is nice to begin the topic by reviewing our understanding of the capital market. The capital market is a sub-set of the financial system that serves as engine of growth in modern economies. It is that section of the financial system that is involved in providing long-term funds for productive use. The capital market therefore provides an option for governments and companies to raise investment capital for the construction of waterworks, bridges, schools and factories and purchase of vehicles, facilities and equipment using such financial instruments such as equities and bonds. The capital market can also be used as a vehicle to acquire other companies. This compares with the money market, which represents the short-end of the financial system that provides facilities for claims and obligations whose maturity vary from one day to one year.

1.2 We can also look at the capital market as the network of institutions and individuals made up of regulators, ad operators who, together, facilitate the smooth operation of the market. In this regard, the capital market constituencies can be broadly divided into four categories, namely:
1.2.1 Provider of funds (investors – individuals, Unit Trusts/mutual funds, pension funds and other institutional investors)
1.2.2 Users of funds (companies and governments and their agencies.
1.2.3 Intermediaries (facilitators – stockbroking houses, issuing houses, registrars, etc.
1.2.4 Regulators (Government Regulatory Agencies, such as SEC, and the Central Bank and self Regulatory Organization such as The Nigerian Stock Exchange)

1.3 As can be seen in the foregoing review of the capital market, while the providers of funds comprise individuals and corporate bodies, the users of funds (issuer of securities) are expected to be companies and governments. In other words, individuals may not be able to raise money from the capital market as they can do in the money market.
Capital Market

- The capital market is a network of institutions and mechanisms through which medium and long-term funds are made available to businesses and governments and instruments outstanding are transferred among investors.
- It establishes rules for fair trading practices and regulates the trading activities of its members according to those rules.
- Stock Exchanges provide a market for the trading of securities to individuals and organizations seeking to invest their saving or excess funds through the purchase of securities.
- Globally, stock exchanges were established for the purpose of facilitating, regulating and controlling the business of buying and selling securities.
- Also it provide facility for buying and selling securities that have been listed for trading on that exchange.
Types of Market

- Globally, two markets are distinct:
  - Primary
  - Secondary
- In the **primary market**, new instruments are sold for cash through investment agents
  - The funds are then used for capital investment in form of retiring outstanding securities of the company, financing new plant or equipment, secure additional working capital, install modern IT infrastructure, branch expansion etc.
- **Cash generated goes to the issuing company**
- In the **secondary market**, only existing securities are traded
  - No new cash is made available for investment.
  - The existence of the secondary market where existing securities can be bought and sold enhances the efficiency of the flow of savings in an economy.
- **Cash generated goes to the selling investors**
Instruments can be divided into:

- **Fixed Income Securities**
  - Incomes derived from such securities are fixed and almost certain to the investors irrespective of the fortunes of the issuer
  - Bonds
  - Unsecured bonds are normally called Debentures
    - Bonds secured by real property are known as mortgage-bonds
  - Mortgage-Backed Securities
  - Asset-Backed Securities

- **Variable Income Securities**
  - Equities
  - Preference shares
    - Combines features of Equities and Bonds
  - Derivative Securities
• **Equity Instruments**
  • Also called ordinary shares or common stock or variable income securities
  • These are the perpetual capital of companies
  • Holders have claims upon the residual profits of a company
  • Holders possess limited liability i.e. A shareholder is not liable for the debts of the company beyond the amount of capital contributed. Unless the shareholder owe the company some unpaid subscription on the shares.
  • Equity holders’ rank last in the distribution of the company’s assets in the event of bankruptcy or liquidation
  • They are the most important element of corporate equity and are far more numerous in the capital structure of companies
  • Holders have rights to vote at meetings
  • There are two sources of return to ordinary share investors: dividend and capital gains.
  • Instead of (and some times in addition to) cash dividends, investors are paid stock dividends which translates to more shares
Benefits of Investing in Equities

- An investor derives the following benefits:
- Participate in the fortunes of the company through dividends - which forms part of the company’s profit
- Growth in portfolio through bonus shares – extra shares fully paid out of reserves which are distributed to existing shareholders
- Growth in portfolio through capital appreciation i.e. as market prices of equities increases
- Right to attend and vote at shareholders meetings
- Use of share certificate as collateral for borrowings
- The feeling of satisfaction in contributing to business and economic growth
Benefits cont.

• Equity investments enable people to save with ease. Such savings are automatically put to work for their owners.

• Avoid the adverse effect of inflation on savings as equities over a long period of time produce compound yields that exceed the rate of inflation.
BOND: A bond is a security (similar to IOU) issued in connection with a borrowing arrangements which obligates the issuer to make specific payments (coupon payments) to the holder over a period of time usually semi-annually.

Bonds generally fall under:

- Corporate Bonds/Debenture.
- Government Bonds
- Federal Government Bonds
- State Government Bonds
- Local Government Bonds
- Municipal Bonds/Notes
- Agency Bonds
TYPES OF BONDS

✓ CORPORATE BONDS
✓ Debenture: an obligation secured by the general credit or earnings capacity of the issuer rather than being backed by a specific lien or property.
✓ Mortgage Bonds/Notes: secured by a lien on property, equipment or other real assets.
✓ Mini-Coupon and Zero-Coupon Bonds
✓ Callable/Non Callable Bonds
✓ Bearer Bonds
✓ Book-Entry/Bonds
✓ General Obligation Bonds
✓ Revenue Bonds
FEATURES OF BONDS

- **PAR VALUE:**
  - Amount paid to the stockholder on maturity of the bond.
  - Discount or premium

- **COUPON INTEREST:**
  - Annual/Semi-annual Naira interest paid to the bondholder

- **MATURITY DATE:**
  - The date on which the issuer is obligated to pay the bondholder

- **SINKING FUND:**
  - Periodical application of money towards redemption of the bonds before maturity.
PRODUCTS CONT’D

**PREFERRED STOCKS:** These are non-voting shares in a company, usually paying a fixed stream of dividends. Popularly known as Preference shares, they have features similar to both equity and bonds. They promise to pay a specified stream of dividends each year. Unlike Bonds, failure to pay the promised dividend does not result in corporate bankruptcy. Instead dividends accumulate but ordinary share holders do not receive any dividends until the preferred stockholders have been paid in full. On liquidation, they rank after bondholders but before ordinary shareholders.
Why would Investment in Bonds be Appropriate?

- Investors seeking steady cash flow
- Investors who do not have an immediate need for the sum invested
- Bonds are excellent vehicle applicable in portfolio diversification

Attraction of Bonds over Equities

- They are loans repayable over a relatively long period of time, hence frees the issuer from short term funding problems thereby permitting long term capital investment
• The interest charge paid by the issuing firm is deducted as an expense from profits before the computation of corporate taxes (tax deductible)

• Interest on bonds are typically paid semi-annually while equity holders are risk bearers

• In the extreme case of liquidation, bondholders are creditors; hence have a claim ahead of equity holders.
Derivative Securities

- Available in most economies but intensity differs
- They are esoteric instruments
- Derivatives are instruments that derive their values from an underlying security (stock, bond or basket of securities)
- Derivatives market does not trade in the basic securities, but on the right to title on the underlying securities on the basis of the future title to the securities.
- Derivatives are available on both financial and real assets
- The financial futures market operates to provide a hedge against exchange and interest rates fluctuations
• Derivatives include futures and options.
  ï Financial futures represent a firm legal commitment between a buyer and seller, where they agree to exchange something at a specified price at the end of a designated time.
  Futures are available on baskets of stocks e.g. S & P 500 Stock Index) and are referred to as Stock Index Futures. Futures on fixed income securities are called interest rate futures
  ï Option is a contract in which the writer of the option grants the buyer of the option the right to purchase from or sell to the writer a designated instrument at a specified price (or receive a cash settlement) within a specified period of time.
• Real Estate
  - One can participate in real estate as a creditor or an owner
  - Direct participation is afforded by the direct acquisition of mortgages or the indirect purchase of mortgage-backed securities
  - Real estate pools that are similar to unit trusts are called real estate investments trusts (REITs)
    - They are available for diversified debt and equity ownership in pools of property of various types.

• Mortgage-Backed Securities
  - Bond backed by mortgages are so called mortgage-backed securities
  - They are usually issued by banks to large institutional investors and by the government and by large mortgage companies
  - The underlying collateral is a pool of mortgages
  - Investors receive payments from the interest and principal on the underlying mortgages
- **Asset-Backed Securities**
  - These are securities issued by a special purpose company that holds a package of low-risk assets whose cash flows are sufficient to service the bonds.
  - Hence, instead of borrowing money directly, Companies sometimes bundle up a group of assets and then sell the cash flows from these assets.
  - It is these securities that are known as asset-backed securities.
  - Various assets are used as collateral.

- **International Equities**
  - Foreign stocks are attractive because many international companies oblige investors with superior return potential.
  - Foreign stocks offer diversification possibilities.
  - Foreign stocks can be acquired directly at foreign stock exchanges by purchasing Global Depository Receipts (GDR) or by acquiring international unit trust or mutual funds.
• **American Depository Receipts/Global Depository Receipts (ADRs/GDRs)**
  - These are investment instruments denominated in dollars and issued through banks to offshore investors. It is a convenient method of raising dollar-denominated capital to meet companies' foreign exchange requirement.
  - They are internationally traded securities linked to the underlying shares of the local companies and provide a route to facilitating foreign investment as they offer a convenient way for international investors to hold shares in the local market.
  - They are negotiable instruments possessing the features of common stocks as each one represents a specific number of shares in a specific foreign company.
  - ADRs are traded on the NYSE, AMEX and OTC markets.
  - ADRs are available only to America Companies and Investors.
• The receipts are registered financial instruments in the country, in which they trade and can be issued, either for existing shares, or as a part of new equity issue.
• There is also a debt side of the ADR/GDR market that could be explored by companies.
• A company issuing GDR may not be quoted on the foreign stock market for Level I issue, but at Levels II and III, it would be necessary to be quoted on the foreign stock market and be subject to its rules and regulations.
• The methodology for raising a GDR involves an internationally depository bank like the Bankers Trust Company of New York, issuing depository receipts denominated in dollars on the basis of shares deposited with a custodian institution.
Participants & Roles in the Capital Market: Regulators

- Securities and Exchange Commission
  - The apex regulatory institution of the capital market
  - Established by Government
  - Registers listed securities
  - Registration of stock exchanges and dealing members
  - Sets the Rules and regulations and ensures compliance
  - Market surveillance to prevent insider abuse
  - Dispute resolution
    - SEC’s Administrative Proceedings Committee
Participants & Roles in the Capital Market: Regulators

- **The Stock Exchange**
  - The Stock Exchange is a place where debt and equity securities of varying types are traded transparently.
  - It is a market that facilitates capital mobilization and allocation, as both governments and companies can raise funds through the market on long and most prudent terms through the offer of shares (by companies) and bonds (by companies and governments).
  - The facility, which the stock exchange provides for trading in existing securities, removes the restriction that would have prevented individuals from investing their savings in securities.
  - The opportunity it offers for subsequent trading in existing securities has made it a decisive factor in the success or otherwise of many corporate issues -
    - The availability of a secondary market - that is, daily trading of securities on the stock exchange - engenders capital formation and socio-economic development.
Other Functions of The Stock Exchange

- Sets Rules and Regulations for Dealing Members
- Licenses Dealing members
- Listing Requirements for issuers of securities
- Facilitates the secondary trading of securities
- Mechanism for dispute resolution
The Nigerian Stock Exchange

• The Nigerian Stock Exchange is a private, non-profit making organization, limited by Guarantee.

• It was incorporated via the inspiration and support of businessmen and the Federal Government via CBN, but owned by about 500 members.
  – Dividend into Dealing members (Stockbroking firms) and Ordinary members - financial institutions and individual Nigerians of high integrity who have contributed to the development of the Stock Market and the Nigerian economy.

• The NSE is a mutual organization.
  – The plan to demutualize was abruptly suspended in April 2009
• **Investor Protection Fund**
  
  ï To settle investors who incurred losses arising from the collapse of a stockbroking firm.
  ï Each stockbroking house contributed N1 million to the fund
  ï Contribution being reviewed for an increase
  ï Fund managed by an independent Board of Trustees.

• **Trade Guarantee Fund**
  
  ï Established to protect the market’s integrity from the inability of a stockbroking firm to settle a transaction
  ï The fund is managed by each of the 23 settlement banks on quarterly rotation basis.
  ï There has been minimal recourse to the use of the fund.
  ï Each stockbroking firm contributed N100,000 to the fund.
  ï Defaulting house suspended from trading
  ï Contribution being reviewed upward
Financing The Nigerian Stock Exchange

- Transaction fees paid by members on every sell side (0.3% of consideration)
- Fees paid by firms when their securities are originally listed
- Annual listing fees (by issuers of listed securities, which is graduated based on September market capitalization derived using the average monthly closing prices of each security between January and September)
- Annual fees paid by dealing members based on the number of stockbrokers employed in each house and a flat fee to cover the cost of maintaining the trading booth.
  - With the redesigning of the trading floor, we now have 223 workstations trading simultaneously aside from remote access.
- Entrance fees from new members
- Subscription to Official Website
- Sale of historic trading and market information
- Penalties by quoted companies and stockbroking firms. (Not regular)
Participants & Roles in the Capital Market: Regulators

- Chartered Institute of Stockbrokers
  - The Chartered Institute of Stockbrokers was established in 1990 and chartered by Act 105 of 1992.
  - Prior to the granting of the Charter, the Institute was known as The Nigerian Institute of Stockbrokers, a company limited by guarantee.
    - Hence did not have an Issued capital
  - The Institute is the professional body statutorily responsible for regulating the practice of stockbroking in Nigeria.
  - The Institute has a Governing Council responsible for the administration and general management of the Institute.
  - The Council consist of the following members:
    - (a) the President of the Institute; who is the chairman;
    - (b) the two Vice-Presidents of the Institute;
    - (c) a representative of the SEC;
    - (d) a representative of The Nigerian Stock Exchange;
• (e) two representatives of the Banker's Committee
• (f) twelve persons to be elected by the Institute;
• (g) two persons to represent institutions of higher learning in Nigeria offering courses leading to an approved qualification to be appointed by the Minister;
• (h) a representative each of the following Ministries, that is -
• (i) Finance;
• (ii) Education; and
• (iii) Women Affairs and Youth Development;
• (i) past Presidents of the Institute who shall be entitled to serve on the Council for a maximum period of three years from the expiration of their terms of office as President of the Institute.
- Functions of the Institute
  - To admit members of the profession in the category of-
    - (a) fellows;
    - (b) members;
    - (c) associates;
    - (d) honorary members;
    - (e) honorary fellows.
  - Publishes the list of current stockbrokers annually
  - Discipline members for offences through the establishment of Disciplinary Tribunal and Investigating Panel
    - The tribunal is known as the Chartered Institute of Stockbrokers Disciplinary Tribunal
    - Charged with the duty of considering and determining any case referred to it by the Investigating Panel
    - The Tribunal consist of the President of the Council and six other members of the Council appointed by the Council.
There is also the Chartered Institute of Stockbrokers Investigating Panel responsible for:

- Conducting a preliminary investigation into any case where it is alleged that a member of the profession has misbehaved in his capacity
- Deciding whether the case should be referred to the Tribunal; or
- Submitting a report on any action taken in the past to the Tribunal.
- The Panel is appointed by the Council and shall consist of four members of the Council and one member who is not a member of the Council.

The Institute funds itself from Members subscription, Examination/Exemption Fees, Sale of Publications (The Stockbroker), Mandatory Continuing Professional Development – MCPD (seminars, Workshop), Annual /Bi-Annual Conferences, subventions from CBN, The NSE etc
Participants & Roles in the Capital Market: Intermediaries

The Issuing House

- This is usually the first party to be appointed to manage floatation
- They take a central role in putting together the prospectus for the issue
- They may also assist in the selection of the other parties.
- The issuing house is also responsible for registering the issue with, and obtaining the approval of the SEC.
- The issuing house also prepares the allotment proposal approved by the issuer for submission to SEC for clearance.
Participants & Roles in the Capital Market: Intermediaries

Registrar

- The registrar is responsible for tallying and analyzing the applications.
- They execute the procedures decided upon for provisional allotment for submission to the issuing house.
- Upon confirmation of the clearance of the allotment proposal by SEC, the registrar sends out stock certificates to successful investors.
- They verify ownership in the dematerialization process.
- Registrars’ fee is based on N30 per old application; N40 per new application.
Participants & Roles in the Capital Market: Intermediaries

The Stockbroker

• He is a licensed dealing member of an Exchange
  ï To deal in financial instruments available in the Money & Capital Markets
• He is to act as sponsor of the issue in his capacity as a dealing member of the Exchange.
• The stockbroker will make the application for listing and handle relationships with the executives of The Exchange responsible for scrutinizing applications.
• The stockbroker is also responsible for leading the parties to, and introducing them at the Quotation Committee meeting and assist in sounding out large potential investors to evaluate interest in the issue.
• The stockbroker is expected to guide the directors of the company on compliance with the listing requirements.
• Ensures that the commission cheques of the stockbrokers that participated in the public issue are prepared and dispatched to them (Usually on the Trading Floor).
Other Roles of a Stockbroker

- Intermediate in the Treasury Bills Market (Money Market)
- Renders advisory and investment management services to clients
- Investment adviser in the government’s privatisation programme
- Performs custodial roles for clients
- Provides facility for margin accounts
- Collects and revalidates dividends for clients
- Act as stockbroker for public issues (IPO, Rights issues)

The Functions, Structure, Size of a stockbroking firm vary in order to satisfy diverse needs of numerous classes of clients

- Roles in the market depend on Capital bases, Expertise and Status of Registration
  - A Broker = N40 Million
  - A Dealer = N30 Million
  - A Broker/Dealer = N70 Million

  - A broker transacts on behalf of customers only while a dealer transacts on behalf of his company
Roles of Stockbrokers in Funds Raising & investment Advice

Advise and Assist Fund Seekers

- Builds on contacts with Institutional investors
- Advise companies on the type of securities that may be offered with the best chance of market acceptance, amount and timing of issue
- Undertakes reorganization exercise for both public and private sectors
- Advice and participate in offer for subscription, mergers and acquisition, future expansion programme etc

Assistance to Capital Providers

- Mainly institutional investors and high networth individuals
- Stockbrokers give advice based on their appraisal of a company and its security and available alternatives
Transacting in Larger Block of Securities for His own Accounts

• To benefit from price appreciation (Buy Low Sell High)

Underwriting of New Issues

• The issuer will be able to finance part or all of his project
• Provides liquidity and promotes transfer of ownership from his trading activities

Stockbroker Commission

• Primary Market: 0.125% of Market Value
• Secondary Market: 0.75 – 1.35% of Consideration (Graduated)
Trustee

• Required when a bond is to be issued
• There is a need to set out the contractual obligations of borrowers and lenders.
• This is constituted in a document called the “Trust Deed” This usually contains among other information:
  – Restriction imposed on the borrower, usually referred to as the covenant
  – Assets to be pledged as security
  – Creditors protection with regards to future additional borrowing by borrower
  – Principal repayment terms
- Interest payment terms
- coupon rate and when payable
- Rights of creditors in case of default
- Bondholders are many and dispersed
- Hence, a Trustee is appointed to protect and enforce the rights of the bondholders as contained in the Trust Deed.

Trustee Minimum Paid Up capital is N40 million

Trustee Fee is between 0.035% – 0.10%
Methods of Accessing the Capital Market

Offer for Subscription

- This is the direct sale of new securities (shares or debentures) to the public before the shares are admitted by The Exchange for trading.
- Guidelines specified by SEC and The NSE are to be complied with before a company can undertake a public offering of its shares.
- It involves the preparation of selling documents – referred to as prospectus and abridged prospectus, underwriting agreement (optional), return sheet, printing of share certificates etc.
- The approval of SEC is required on pricing, timing and amount to be offered.
- The NSE approval is required for listing, certificates of exemption.
• Section 553 of the CAMA empowers The NSE to issue Certificate of Exemption from the requirements of the Act relating to the form and content of a Prospectus.
• The Certificate of Exemption is required to exempt the issuing-company from printing the detailed prospectus or rights Circular to be distributed to the investors.
  – They would have only the abridged version.
  – The detailed document will be available with the stockbrokers and receiving banks for scrutiny.
Listing By Introduction

- Applicable where a company seeking listing has met the minimum requirements with regard to the spread and percentage of the issued shares held by the public.
- The process does not lead to raising of funds but allows the company participate in the market through secondary market operations.
- The full complement of parties to an issue is not required
  - It is cost saving
Rights Issue

- Offer made to existing shareholders to acquire more shares in the company usually at a concessionary price.
- The method is used when the majority of the existing shareholders do not want a dilution of the shareholding structure and they are willing to provide the additional capital required by the company.
- Rights are offered in proportion to existing shareholding.
- May be in varying proportions i.e. 2:1 read as 2 for 1
  - For every one share being held, the holder is entitled to purchase an additional two.
- Rights can also be offered as derivatives to new shareholders.
  - Investors not willing to take up their Rights can sell it on the floor at a price, which may allow new shareholders to invest in the company and permit existing shareholders to increase their holdings.
Bonus/Scrip Dividend

- Also known as free issue.
- It is a method through which companies increase their capitalization without selling additional shares.
- The effect is to increase the paid up share capital.
- A company with accumulated capital reserves/share premium out of line with its issued capital may decide to give additional shares to existing shareholders in bonus.
- It may be offered as a substitute or complement to cash dividend.
- Scrip issues are offered in proportion to existing shareholding at no cost.
• With e-bonus, shareholders account in the depository are credited directly with the bonus
• The shareholders after receiving the notice can sell all or part of it on the Trading Floor.
• For a company to issue scrip, it requires the recommendation of the Board of Directors to the shareholders at the AGM for approval.
• If the authorized capital of the company will be affected, i.e. if the paid up capital and bonus issue will overshoot the authorized capital, then the company should seek to increase the authorized share capital with the Corporate Affairs Commission before undertaking the scrip issue.
Offer for Sale

• Occurs when there is need to replace the equity interest of existing shareholders.
• The fund realized go to the shareholders whose shares are being offered for sale.
• Offer for sale has no influence on the balance sheet of the company.
  – The process will not lead to a change in the issued shares of the company.
Private Placement

- Securities of a company are sold to clients of the issuing house/stockbrokers handling the issue.
- Instead of being offered to the general public or to existing shareholders.
- Private placement involves the invitation to selected high net worth individuals or corporate organizations to invest in a company’s issue.
- Companies usually embark upon the process when the promoters do not want complete dilution of control.
- As the securities are not yet listed on the stock exchange, promoters do not need to meet the exchange requirement for public issue.
- By SEC directive, Companies undertaking Private Placement are to inform investors on whether there are plans to list on The Exchange.
• Stock Split
• Prompted when the Company’s stock price has risen to a level that management feels is out of the popular trading range
• The occurrence of this anomaly will cause a decline in the trading volume of the shares
• The outcome of a stock split is for the Company to end up with more outstanding shares that would sell at a lower price and have a lower par value than before the split
• Split can occur at any ratio of new-to-old shares
• Several popular ratios are 2-for-1, 3-for-2 and 5-for-4
Determining Appropriate Price for a Security

Commonly used valuation methods include

- Asset based valuation
  - Value the assets of the company
  - Establish value of outstanding liabilities
  - Obtain net asset value (NAV) by deducting outstanding liabilities from asset value
  - NAV – Value of equity

This method alone is not appropriate for a going-concern
• Earnings-based valuation
  * Find the weighted average PAT for the past 5 years
  * Multiply the weighted average PAT by an appropriate P/E ratio to obtain value of equity

This method can be used alone or in combination with other methods.
• Discounted future cash flow valuation
  * Prepare a forecast into the future of the business future free cash flows.
  * Identify an appropriate point in the future to treat as terminal year (5 to 10 years into the future)
  * Treat all future cash flows from the terminal years as a growing perpetuity
  * Apply an appropriate discount rate to the resulting free cash flow values
Stages in Accessing the Capital Market

• INTRODUCTION

• From beginning to end, the process of taking a private company to the Daily Official List of The Nigerian Stock Exchange can be broken down into stages. The stages are:
  • Consultation/Discussion Stage
  • Decision Making/Mandate Stage
  • Documentation/Packaging Stage
  • Regulatory – NSE Quotation Approval/SEC Registration Stage
  • Completion Board Meeting Stage
  • Distribution/Marketing Stage
  • Range of Analysis/Allotment Stage
  • General Undertaking/Declaration of Compliance Stage
  • Listing Stage
1. Consultation/Discussion Stage

A company that desires to raise funds and is considering the stock market option may approach its local banker or an issuing house.

Alternatively, an issuing house may approach a company with a proposal for re-capitalization through the stock market. If the initiative is from an issuing house, the benefits of public quotation will be explained to the company.
Decision Making/Mandate Stage

- After discussions with the proposed issuing house, the management or Board or owners will meet and resolve to go public. This meeting could be held alone or with the financial advisers in attendance. The memorandum and articles of association will be suitably amended through passing the necessary resolutions to facilitate this.

- A successful public quotation process is a product of team effort and the composition of that team will be a crucial factor in the outcome of the exercise. Professional advisers, which a company had used in the past, may not necessarily be suitable or experienced to take the company to the market because of the specialist input required.
Parties to an Issue

In any public quotation or public offer process, the following parties (or some of them) are involved:

- The Issuing House
- The Stockbroker to the Issue
- The Reporting Accountant
- The Solicitor to the Issue
- Underwriter
- Registrar to the Issue
- Receiving Banker
- Trustee
- Solicitor to the Trustee
Documentation/Packaging Process

- After all the parties to the issue have been appointed, the first all parties meeting is called.
- At this meeting, functions are allocated to everybody and a timetable of the issue is also drawn up.
- Costs and fees are agreed and all the parties proceed to work and package the issue.
- If need be, a second all parties meeting is held to finalize and get the application ready.
- For a fast tract approval of the Council of The Nigerian Stock Exchange, the application to The Exchange must be accompanied with the following documents:
• Detailed Application (2 copies);
• Listing fee;
• Abridged Application for Quotation and Listing on The Nigerian Stock Exchange (20 copies) specimen copies of the abridged form are attached (Appendix);
• Certificate of Incorporation and evidence of attaining a Public Limited Company (PLC) status (2 copies);
• Memorandum and Articles of Association (2 copies);
• Certified copy of the Board Resolution:
  ï Authorizing the issue of all securities for which listing is sought;
  ï Approving or authorizing the issue of the prospectus; and
  ï Increasing the share capital of the company in order to absorb the proposed issue.
• Audited accounts (1 copy) for each of the 5 (or 3) completed financial years of the applicant company immediately preceding the date of the application;
• A copy of the draft Trust Deed (or document securing or constituting the stock), which must comply with the Listing Requirements (this is applicable in case of loan stock or debenture);

• A copy of the draft Underwriting Agreement (where applicable) and commitment letters from the consortium of underwriters. A signed copy must be submitted after execution of the underwriting agreement;

• A true copy of the Reporting Accountants statement on:
  • 5 years financial results, incorporating statement of adjustments; and
  • The profit forecast and the cash flow projections for the next 2 to 3 years.

• A copy of the pricing proposal submitted to the Securities and Exchange Commission (SEC);

• A copy of the Draft Prospectus;

• Estimated cost of the issues (final cost must be submitted later);

• Offer Time Table;
• A certified copy of every report, valuation, resolution or other document any of which is extracted or referred to in the prospectus;
• Consent letters from all the parties to the issue;
• Updated list of Receiving Agents.
NSE Quotations Approval/SEC Registration Stage

- The Stockbroker submits the application to The NSE with a covering letter and the NSE application fees for registration and queuing for the next Quotations Committee meeting, which is usually the last Thursday of the month.
- The Stockbroker will continue his liaison with the Quotations Department to clarify any possible queries and to know the date of the Quotations Committee meeting in order to inform the issuer.
- The following officers/parties must appear and defend the application before the Quotations Committee of Council:
• The CEO of the Issuer Company;
• The Company Secretary;
• The Head of Finance or Chief Accountant;
• The CEO of the Issuing House;
• Solicitor to the Company/Issue;
• Trustees and their solicitors (in case of debentures);
• The Registrars, the Chairman and other Board members and management staff (optional).
• The Stockbroker to the issue leads the delegation to the Quotation Committee meeting to defend the application.
• The Stockbroker introduces the Issuer’s team to the Quotations Committee.
• If the application is successful, the Stockbroker will be informed and he should liaise with The Exchange for the collection of the approval letter. If the application is rejected, the Stockbroker/Issuing House is informed of the reason for the rejection. The Quotations Department may suggest ways for repackaging the application to meet the expectations of The Exchange. In the same vein, the Issuing House files an application with SEC, ensures that approval is granted and the collects SEC’s approval letter.
Completion Board Meeting Stage

- Upon final approval by the Committee, The Exchange issues a letter of approval to indicate that the issue may proceed. However, before the exchange issues the Certificate of Exemption, the following offer documents must be submitted with a request for the Certificate, seven (7) working days to the proposed date for the Completion Board Meeting:
  - An letter indemnifying The Exchange from any loss associated with any litigation arising from the issue
  - The proof-print of the Prospectus
  - The proof-print of the Abridged Particulars of the Prospectus
  - The proof-print of the Advertisement and Posters
  - The updated Offer timetable and cost of Issue.
• If the request for a Certificate of Exemption is not submitted early enough, it might not be available before the Completion Board meeting because the DG/CEO of The Exchange has to personally sign the certificate.

• All parties to the issue, including the directors of the issuing company, will meet (at the “Completion Board Meeting”) to issue and sign the offer documents holding themselves individually and severally liable for all information contained in the prospectus and other offer documents. The Certificate of Exemption confers on the issuer the right to issue and circulate an abridged version of the detailed prospectus. If the issue is underwritten, the underwriting proceeds are paid at this stage.

• After the Completion Board meeting and before the offer opens to the public, copies of the documents executed at the Completion Board meeting will have to be lodged with The Nigerian Stock Exchange.
Distribution/Marketing Stage

• The Issuing House distributes application forms to all receiving agents.
• The required number (50 copies of abridged and 25 copies of hardcover) is submitted to The Exchange for distribution to Branches and Council Members.
• The application list opens on the selected date and closes after 4 to 6 weeks. If extension in the application closure date is required, the Stockbroker must get the written approval of The Exchange.
• Any variation in the offer documents (both prospectus and other documents) must also be supported with the written approval of The Exchange.
• A similar approval must also be sought and obtained from SEC by the Issuing House.
The launch of a new public company on the stock market is a delicate operation, which requires favorable conditions for a successful outcome.

Two of the most important elements are timing and pricing.

A listing which, is otherwise sound, can fail if the timing is poorly judged.

If all other circumstances are positive, the market is not likely to accept an issue, which is over-priced.
Range of Analysis/Allotment Stage

- If the issue is oversubscribed, the Registrar prepares a range of analysis on how the securities should be allotted.
- After the range is agreed upon, allotment is done and the pattern used is sent to SEC for information.
- A copy of the allotment pattern is also sent to The NSE for information.
- Monies in respect of unsuccessful/rejected applications are returned.
- Applications may be rejected because of incidences of multiple applications or the applications were not under seal (in the case of companies).
- If the issue is under-subscribed, every subscriber is allotted in full and the balance of the security is warehoused if there is no standby underwriting.
- If the issue subscription is under 25% the issue is aborted and the proceeds returned to subscribers.
- At the conclusion of allotment, allottees are sent share certificates or Account in Depository credited in case of e-ipo.
- The payments of proceeds are made to the issuer along with commission to receiving agents (stockbrokers and banks).
General Undertaking/Declaration of Compliance Stage

• Application for listing supported by:
  ✓ Copy of approved allotment proposal
  ✓ Newspaper cutting of announcement of the allotment
  ✓ Evidence of dispatch of return monies and share certificates
  ✓ Executed “General Undertaking & Declaration of Compliance

• General Undertaking & Declaration of Compliance to be signed by a director & Company Secretary under seal

  ▪ At this point the company also requests for a listing date.
Listing On The Exchange

On the date the company is to be listed, it is mandatory for the Stockbroker, CEO, Company Secretary, Finance Director and Registrar of the company to come to The Exchange for briefing at 9.30 a.m. They will be informed of the importance of complying with the post listing requirements, submitting timely reports to The Exchange and getting approval before publishing any reports, notices or circulars. The Chairman of the Board of Directors and other members of the management team may also attend the briefing and/or listing sessions, but it is not mandatory for them. The Quotations Department will arrange for the team to have copies of the Daily Official List for that day and to attend and observe the day’s trading at the Floor. Thereafter, the company will be listed on the Daily Official List.
Merits of Listing

- **Profile** – A stock exchange listing leads to enhanced publicity, which assists companies in expanding market share or breaking into new markets. An enhanced profile also helps in the recruitment of high quality staff.

- **Raising Capital** – Listed companies find it easier to find investors prepared to acquire new shares, thus raising additional capital to finance expansion.

- **Acquisition Opportunities** – Listed companies are in a better position to expand through acquisition using own stock, e.g. Total merger with Elf and Unipetrol takeover of Agip were both done using stocks.

- **Exit Route for Current Owners** – A listing enables the current owners of the company to sell down more easily part or all of their company, thus realizing cash.
Post Issue

Documentation Requirements

• At this stage, the company prepares and delivers to The Exchange, the following documents:

• Copy of the Approved Allotment Proposal;

• Newspaper cutting of the Announcement of Allotment in the newspapers;

• Form of General Undertaking proposal on the letterhead paper of the applicant company.

• Declaration of Compliance in the form outlined in the Listing Requirement

• The Company Secretary and a Director must sign the General Undertaking and the Declaration of Compliance, which must be under the company’s seal.

• On submitting these documents, the company can request for a listing date
To provide guarantees for the success of a public offer, the issuing company may arrange partial or full underwriting of the shares to be issued.

The issuing house is, in fact, obliged to underwrite at least 80% of the issue.

Underwriting is a financial intermediation process involving risk bearing by the Underwriter who gives the Issuing Company a firm price when marketing a primary issue.

An underwriting contract is, therefore, a guarantee that in the event of under-subscription, the underwriter will pay an agreed amount to the issuing company and take possession of the un-subscribed shares (to be warehoused) for sale later on The Floor of The Exchange.
Three forms of underwriting are set out in the ISA 1999:

- **Best Effort basis:** An Underwriting term in which the Underwriter agrees to do his best to sell as many shares as possible to the public.
- He does not buy the securities outright
- The Underwriter has no liability for unsold shares
- **Firm Underwriting** – Take all the remaining unsubscribed portion after issue
- **Standby basis** – Here, the underwriter makes a firm commitment to take any balance of the issue unsubscribed by investors. Proceeds of the issue including the underwriting commitment made available to the issuer within six weeks from the close of subscription lists.
- Underwriting commission is Negotiable
- A minimum paid up capital of N100 million is set for Underwriting Companies
- Underwriting commitments not disposed off within six months must be reported to SEC.
Market Efficiency

- Efficiency implies that all resources are being used to the potential.
- Information Efficiency implies the Price of a Security reflects ALL information relevant to pricing the Security.
  - A pricing efficient market implies efficiency in the processing of information i.e. the prices of capital assets at all times are based on correct evaluation of all available information
- Allocation Efficiency relates to the ability of the market to direct capital to the projects with the highest risk-adjusted returns.
- Operational Efficiency is achieved when transactions completed on a timely basis, accurately and at low cost.
Efficient Capital Markets

Efficient Capital Markets are markets in which the security prices fully reflect all relevant information that is available about the fundamental value of the securities.

- Fundamental Value is the Present Value of the Future Cash Flows that the owner of the security expects to receive.

- The anticipated cash flows for stocks consist of the Stream of expected dividends plus the expected price of the stock when sold.

- New information about the fundamental value of the securities will be reflected in price through competitive trading.

- The Search for mispriced stocks by Analysts and their subsequent trading make the market efficient and make prices reflect fundamental values.
Efficient Market Hypothesis (EMH)

- EMH is about the way the market processes information and how the information influences security prices.
- EMH postulates that it is impossible to “beat the market” because existing share prices always incorporate and reflect all relevant information.
  - All historical information on prices and volumes are already reflected in current market prices.
  - Therefore past performance has no influence on future performance or market values.
- Hence, it is impossible for investors to either purchase undervalued stocks or sell stocks for inflated prices.
- A stock’s price is equal to its investment value.
- EMH Classifies Efficiency into three levels: WEAK, SEMI-STRONG AND STRONG FORMS.
  - These are distinguished by the degree of information reflected in security prices.
Weak Form of Efficiency

- EMH in its weak variant implies that successive stock prices are mostly unrelated and that prices tend to move in a random manner or walk.
- Randomness being confirmed by analysis of successive price changes indicating low serial correlation coefficient.
- It is impossible to make consistently superior profits by studying past prices.
Semi-Strong Form of Efficiency

- Security prices reflect past prices and all publicly available information.
- Only traders with access to non-public information can earn excess profits.
Strong Form of Efficiency

- Prices reflect all the information that can be acquired by painstaking analysis of the company and the economy
- We would observe lucky and unlucky investors in the market
- No investor can consistently beat the market
EMH, Technical and Fundamental Analyses: Basic Difference

- EMH is concerned with the impact of information on stock prices.
- The view of EMH proponents is that prices will adjust instantaneously to a shift in market fundamentals.
- It is different from fundamental analysis, which requires that investment selection process be based on certain fundamental economic, industry and company variables.
- Similarly, the aim of Technical Analysis is to detect whether there are recurring and predictable pattern in stock prices, which can be used to generate abnormal trading profits.
- The technicians believe that shifts in market fundamentals can be detected before the impact of those shifts is fully reflected in prices.
- Technicians also believe that irrational forces affect market fundamentals. Hence the underlying trend would be accompanied by random fluctuations in prices. If the market adjusts slowly to this random fluctuation, there will be opportunities for abnormal profit.
• Financial markets in advanced countries are more efficient than their counterparts in developing countries.

• This can be attributed to the following:
  – Lower level of development in information technology and communications,
  – Insufficient number of skilled analysts
  – Lack of investor sophistication
  – Inadequate regulation to control sharp practices
  – High transaction costs.
Information Efficiency is necessary if funds allocated through the capital market are to flow to the highest valued-projects

Shareholders desire maximum stock prices

Maximization of stock prices can result in the capital market directing funds to the most valuable projects only if stocks are efficiently priced in the sense of accurately reflecting the fundamental value of all expected future cash flows.

According to EMH, a market is efficient if it functions in such a way that transactions costs to buyers and sellers in the market are relatively low and information on new developments is quickly disseminated to all parties.

Risk has its reward and on average, investors obtain greater returns for incurring greater risks. Consequently, if investments are always efficiently priced in the market, the only way for the average investor to obtain above average return is to take on more risk.
• Over the years, numerous studies have found that the capital market are weak form efficient while some have reported semi-strong form efficiency.
• Markets do not appear to be strong-form efficient
• Hence, possessors of inside information have a definite advantage over the average investor.
• Professional fund managers access to inside information CANNOT consistently obtain returns above the entire market average. Unless they are willing to take on an above average level of risk.
Trading and Settlement Systems

Types of Trading

• Spot: A trade in which cash is paid for immediate delivery
• Future Trade: Price is agreed now but actual payment and transfer of goods are in the future
• The Nigerian Stock Exchange at inception started with Call-Over or Open Outcry of orders
• Introduced Automated Trading System (ATS) on April 27, 1999
• All 13 Trading Floors are connected to the Trading Engine
  – For on line real time access
  – Remote Trading from offices of Dealing member firms
• Possess electronic surveillance capabilities
• Tightly coupled interface with the Clearing House
Important Concepts

Bull

• An adjective to describe an upward price stock movement
• A person who believes that security price will rise and who buys on that assumption
• Bulls are market optimists and take a favorable or constructive view of business conditions
• One may be a bull on a particular security without being bullish on the entire market
• The successful trader is neither going to be a bull or a bear but one who adjusts his attitude to fundamental conditions
Bear

- A person who believes that security price will decline
- It is more particularly applied to a market in which the downward tendency has been prolonged or is expected to be prolonged, with minor upward interruptions, over an extended period such as a year or more
- If allowed by regulation, a bear can profit from a declining stock market by selling a stock short

Below Par

- A price quoted below the face value of a security

Stag

- A Speculator who buys and sells stocks rapidly for fast profits
Spread

- The difference between the bid and offer prices of a security
- This difference maybe narrow or wide depending upon the demand and supply of the particular issue and the activity of its market

Stock Dividend

- The payment of dividend in the form of shares rather than cash
What is a Central Depository

- It is a facility (or an institution) for holding securities, which enables securities transactions to be processed by book entry.
- Physical securities may be immobilized by the Depository or securities may be dematerialized (i.e. so that they exist only as electronic records).
- In addition to safekeeping, a CSD may incorporate custodian, clearing and settlement functions.
- A Depository (CSCS) is an organization like a Central Bank where the securities of a shareholder are held in electronic form through the medium of a Stock broking firm/Depository Participant.
- It is a centralized bank for shares.
How the Depository Works

- The Depository System functions very much like the banking system.
- A bank holds funds in accounts whereas a Depository holds securities in accounts for its clients.
- A Bank transfers funds between accounts whereas a Depository transfers securities between accounts.
- In both systems, the transfer of funds or securities happens without the actual handling of funds or securities.
- Both the Banks and the Depository are accountable for the safe keeping of funds and securities respectively.
The Central Securities Clearing System

• The Central Securities Clearing System Limited was incorporated on July 29, 1992 as a subsidiary of The Nigerian stock Exchange.
• It operates a computerized clearing, settlement and delivery system for transactions in shares listed on The Stock Exchange.

• **Functions:**
  • Central depository for share certificates of companies quoted on The Nigerian Stock Exchange.
  • Sub-registry for all quoted securities (in conjunction with registrars of quoted companies)
  • Issuer of central securities identification numbers to stockbrokers and investors
  • Clearing and settlement of transactions
  • Safe Keeping/Custodian (in conjunction with custodian member(s) for local and foreign instruments).
  • The Central Securities Clearing System (CSCS) Ltd. was commissioned on April 8, 1997 and commenced operations on April 14, 1997.
• **Stock Market Delivery And Settlement Process Prior To CSCS**

• In most cases, it took between 3 months - 12 months to receive Share Certificates
• Cancellation and frequent issuance and re-issuance of Certificates after sales of shares
• Constant signature verification
• Capital Gains was not exploited
• Some Dealing Members sold what they did not have while some bought without money to pay.
• Numerous complaints on failed transactions
• Loss of Certificates
• Risk was very high - undue delay, manually operated, manipulations due to long transaction cycle, minimal transparency, therefore general lack of confidence in the system
• These problems were worldwide and needed solution. Thus, CSCS was established to speed up the delivery and settlement system of the capital market
• **T+3 Settlement Cycle - Procedure**

  • **Day T.** By 4 p.m. of Day T (Transaction Day), CSCS sends advice of Day T stockbroking firms’ net financial obligations to their respective settlement banks. This is information to alert the banks about their client’s commitment on Day T+3. (Not to be used for any update by the banks).

  • **Day T+2** By 12.00 noon of Day T+2, settlement banks alert CSCS about the possibility of any broker’s inability to meet his financial obligation on Day T+3. The alert can be by fax, e-mail, letter or telephone. Stockbroking firms are to verify from their settlement banks, The NSE and CSCS their ability to meet their financial obligation of their Day T transactions on Day T+3.

  • By 5 p.m. of Day T+2, CSCS sends advice of Day T transactions, stockbroking firms’ net financial obligations to their respective settlement banks for processing.
• At the same time, Inter-bank settlement advice/instruction for Day T transaction is forwarded to Nigerian Inter Bank Settlement System (NIBSS) – a subsidiary of Central Bank of Nigeria to be applied (for processing) on Day T+3 at the Beginning of Day (BOD).

• **Day T+3** By 9.00 a.m. stockbroking firms/custodians or any high net-worth individual must have funded their accounts for Day T transaction.

• NIBSS debit or credit settlement banks’ CBN account in accordance with the Inter-bank settlement instruction received from CSCS Ltd.

• Settlement banks debit and/or credit on Day T+3, Stock settlement effected on Day T+3. In effect, Delivery versus Payment (DvP) assured.
• **Problems encountered with stockbrokers and registrars?**

• Occasional unauthorized stock transactions on clients account by some stockbroking firms

• Various errors on the Certificate Deposit Forms accompanying the share

• Certificates lodged in CSCS for processing which are returned for correction.

• Use of multiple share certificate numbers which are rejected by the system and returned to the registrar for provision of unique certificate numbers

• Late lodgement of share certificates in CSCS Ltd by some registrars.
• **Electronic Bonus (E-Bonus)**

• The Securities and Exchange Commission (SEC) and The Nigerian Stock Exchange (NSE), the regulators of the Nigerian capital market, formally announced their approval for electronic bonus (e-bonus) shares in September and December 2004 respectively.

• E-bonus refers to electronic form of bonus shares.

• It means that when a Quoted Company declares script or bonus issues, rather than issue physical bonus share certificates to investors, they are converted to electronic form and credited to the investors stock account in the Central Securities Clearing System (CSCS) depository under the investors stockbroking firm account with CSCS and a credit advice sent to the investor.
Benefits of Electronic Bonus

- E-bonus enables shareholder’s stock accounts to be automatically and electronically credited with their bonus shares in CSCS System for immediate transaction.
- Electronic bonus shares would eliminate postal delays and loss of certificates in transit.
- E-bonus hastens stock transactions which is time saving.
- Shareholders can easily take advantage of price movements immediately after approval of bonus shares, which would enhance liquidity in the market.
- Share certificate forgeries and theft are eliminated.
- E-bonus will save cost of printing bonus certificates, postages, replacements etc.
• The cumbersome process associated with bonus share certificates including verification are eliminated.
• Shareholders can easily update and know their shareholding at a glance, which makes stock account reconciliation easier.
• Improved confidence and transparency in the capital market.
• It simplifies Share Transmission and Nominal Transfers
• The need for special storage facilities (safes or fire proof cabinets) for certificates and space are eliminated. E-bonus is the safest and quickest method of handling such security documents.
• It internationalizes bonus issue and places the Nigerian capital market on the same pedestal with international capital market where share certificateless system has been operational.
• No more unclaimed bonus and all associated costs.
Benefits of the Central Depository

• Short stock transaction cycle (T+3 days)
• Transparent stock transaction
• Guaranteed delivery and payment for shares.
• Ability to use shares in the CSCS as collateral to obtain loan facility
• Ease of monitoring and updating stock holdings.
• Centralized registry thus reduces cost of portfolio management
• Ability of tracking down history of transactions
Challenges

• Initial Funding difficulties. There was no money to establish the CSCS. The stock exchange literally went cap-in-hand looking for fund to establish the CSCS. Some patriotic Nigerians, individuals put their money on the line to establish CSCS.

• Manpower problem

• Broadening the income stream of CSCS in the face of the global meltdown and decline in share prices

• Power supply.

• Convincing Nigerians to deposit share certificates into the system.
  ï Nigerians were not convinced that they should part with their share certificates.
Automated Clearing

Dematerialization

- This is the elimination of physical certificates or documents of title which represent ownership of securities so that securities exist only as accounting records.

- Dematerialisation ("Demat" in short form) signifies conversion of a share certificate from its physical form to electronic form for the same number of holding which is credited to the investors account opened with a Stock broking firm/Depository Participant (DP) or in custody of a Central Securities Depository.
The benefits of dematerialization

- Trading in the secondary market now requires investors to have a demat account with the CSCS through their Depository Participants. With this development, electronic transaction will be the only way everyone will trade.
- All risks associated with physical certificates such as delays, loss in transit, theft, mutilation, bad deliveries, etc. are eliminated.
- The concept of an “odd lot” in respect of dematerialized shares stands abolished, i.e. in the demat mode, market lot becomes one share.
- Dematerialized securities are most preferred by banks and other financiers for providing credit facility against securities. Generally, demat securities attract lower margin and lower rates of interest compared to physical securities.
The payment mechanism (usually through a broker) between the buyer and seller continues to be as before. Also the usual brokerage fees and statutory charges would have to be incurred. However, both the Cash and Stock settlements occur same day for scripless trading which means Delivery versus Payment (DvP) in practice.

Shares bought are transferred in your name on the very settlement day. Transfer of ownership takes four (4) working days (i.e. T + 3 settlement cycle).

- No courier / postal charges for sending share certificates / transfer deeds.
- Facility for freezing / locking of investor accounts, which enables you to make your account non-operational, for instance if you are abroad.
- Investors prefer to buy shares which are already in dematerialised form.
How you demat your shares?

• A market can make a choice of the transition mode to dematerialization that is considered effective and efficient for the region, investors’ interest being paramount.

• Possible options may include:
  iT A one-time full dematerialization
  iT A gradual approach

• Regardless of the approach being adopted, shareholders need to open a demat account with CSCS through their Stockbroking firm (Depository Participant).

• The investor would be given a unique Clearing House Number (CHN), which must be quoted in all correspondence with any Depository Participant.
The Stock Index

• An Index is a numerical value used to measure changes in a variable or group of variables.
• The Index is set at a hypothetical numerical level on the base period or starting point against which a percentage change can be compared to at any particular point of time.
• The Stock Market Index is a specialized tool used essentially to capture the overall performance of the stock market.
• An index can also be employed to measure how well a given equity or bond portfolio is performing.
• If an investor owns more than one stock, it is cumbersome to follow each stock individually to determine the composite performance of the portfolio.
• Hence, to supply investors with a composite report on market performance, some investment firms (such as Arbitrage, Vetiva, Afrinvest, Dynamic Portfolios to mention just a few) have developed stock market indexes.
• Indexes generally enhance and support the business of stockbrokers, investment banks, analysts and the financial press.
• The stock index will reveal the overall trend in the equity market. In other words, how in general the market is performing?

• It is a comprehensive measure of market trends indicating the general stock market price movements. Thus, the index will be the investor’s yardstick for the level of the whole stock market, or a certain group of stocks, against which the performance of individual stocks/portfolio can be measured or judged.

• Indices are global instruments used by investors in developed as well as developing markets.

• Usually, indexes are constructed with a particular objective in mind and they differ with respect to the stocks included in the basket, method of weighting and the procedure for computation.
  ï Also, we have equity and bond indexes.

• The index measures the moves up or down of stocks or bonds or funds etc reflecting market price and market direction.
Indexes can be either broad or sample-based.

- **Broad based indexes**
- are composed of a large number of stocks with the objective of reflecting movements in large or generalized markets
- **Sample-based indexes** are composed of smaller numbers of stocks and have the objective of reflecting movements in small or focused markets.
- The assumption is that a small percentage of the total population will provide valid indications of the behaviour of the total population if the sample is properly selected.
Notable Examples of Broad-based Indexes are:

- Standard and Poor’s Indexes
- American Stock Exchange Index
- New York Stock Exchange Index
- Dow Jones Equity Market Index
- Wilshire 5000 Equity Index
- NASDAQ Series
- The Russell Indexes
- Tokyo Stock Exchange price Index (TOPIX)
- Nigerian Stock Exchange Index
• **Sample-based indexes**
  
  The notable feature of the available sample indexes is that they are composed of all the highly capitalized and perhaps the most profitable companies spread across key sectors of the economy.
  
  Few samples were concentrated on because; over time analysis has shown that about 50 equities accounted for between 89 – 94 per cent of the total market capitalization.
  
  By concentrating on only a carefully selected sample, analysts are able to study performance and make valid predictions on the overall market.
  
  The results obtained will be comparable to that obtained by taking higher sample or the entire market.
• General Guidelines for including stocks in a sample-based index include:
• Companies with largest market value within their industry,
• Companies must be in important industry segments within the country’s economy
• Ownership of the companies outstanding shares is carefully analyzed in order to include widely held companies and reject closely held companies
• Ample liquidity and efficient share pricing on the stock, both the financial and operating conditions of the company must be analyzed in order to include companies that are relatively stable.
• **Notable examples of Sample-based indexes are:**

• Dow Jones Industrial Average composed of 30 large, well known industrial stocks that are the leaders in their industry (blue chips) and are listed on the NYSE. This is the oldest and most popular stock market index. The index is price-weighted; hence a higher priced stock carries more weight than a low-priced stock.

• Nikkei Stock Average Index also referred to as the Nikkei-Dow Jones Average based in Japan utilizing 225 of the stocks listed on the First Section of the Tokyo Stock Exchange (TSE). Also price-weighted and is the most well known series in Japan.

• CAC based in France and composed of 40 liquid blue chip stocks

• The FT-SE 100 (The Footsie) based in UK initiated in 1984

• The FT-SE Mid 250 based in UK introduced in 1992

• The Listing on any major sample-based index is regarded as a status symbol, which strengthens corporate image, and improves access to funds.
The Stock Exchange All-Share Index

- The Exchange has since January 3, 1984 published a stock exchange index.
- The index is an aggregate of the market capitalization of all of the industrial equities listed in the market. The computation of the index is explained below.
- It started with a base value of 100.
- Value-weighted indexes are generated by deriving the initial total market capitalization of the included stocks.
- Subsequently, a new market value is computed for all equities in the index and current market value \( (t) \) is divided by the preceding market value \( (t-1) \), which is multiplied by the preceding index value.
The NSE Index is given by the formula:

- Current Market Value of Companies \times \frac{X}{Preceding Index Value}

Preceding Market Value of Companies

**Index Maintenance**

- The NSE Index is computed on daily basis.
- This involves daily monitoring the stock market for any stock price adjustment, company additions/deletions, cash/stock dividends and share changes due to listing of additional shares.
• These actions may necessitate adjustments to either the current price or outstanding shares issued by the company or both which invariably may change the company and overall market capitalization.

**Base Adjustment in The NSE Index**

• Such adjustment is designed to make the Index after the changes equal to the Index before the changes.

• The changes envisaged here include new listings, delistings, and increase in the issued capital of listed companies.

• Conversely, it is undertaken when non-market events occurred on the market especially when the capitalization of a company stock is artificially adjusted. This may occur under the following circumstances:

  • **Additional share listing by companies through Rights/IPOs/POs**
  • **Delistings / Mergers / Spin-offs**
• To compensate for these, the base is adjusted such that the index value after the event is equal to the value before the event.
• Base adjustment is undertaken after the close of trading.
• This adjustment ensures that the new value of the index is the same as it would have been without the non-market event.
Importance of Stock Index

• **The Index Summarizes the Entire Market:** The market capitalization figures run into trillions, while index figures are shorter.

• **To Measure Market Performance:** A primary application is to obtain total returns for the entire market or some component of it over specified time period and apply the rates of return computed as a benchmark to judge the performance of individual portfolio managers.

• **For Performance Benchmarking:** It is now a normal practice for fund managers to use indexes as benchmarks for evaluating their portfolio.

• **To Develop Indexed Portfolio:** In active and developed stock markets, it is usually difficult for fund managers to consistently outperform specified market indices. As an alternative, fund managers invest in a portfolio that will emulate this market portfolio. The obvious alternative is to invest in a portfolio that would emulate the market portfolio.
   
   - This led to the creation of index funds whose purpose is to track the performance of the specified index over time and derive similar rates of return.
• **Marketing Instruments:** International investors can compare the performance of the country’s index to other indices around the world.

• **To Forecast:** This is based on the belief that past price changes can be used to predict future price movements. Prices of companies represented in the index are equivalent to the present value of future cash flows. If future cash flows are expected to change (increase or decrease), the index will reflect these expectations.

• **For Inter-Country Comparisons:** Indexes are used to analyze events and returns in the stock and bond markets of different countries.

• **Allows for Self-Regulating Markets:** With indices, arbitrageurs can easily identify discrepancies in the market and correct the market to ensure that prices are accurate.
THANKS FOR LISTENING!