A STUDY OF INDIVIDUAL INVESTORS IN THE CAPITAL MARKET IN KERALA

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By

TOMY VARGHESE
Reg. No. 1517

under the supervision of
Dr. C. A. FRANCIS
Professor
School of Management Studies
Cochin University of Science and Technology

DEPARTMENT OF APPLIED ECONOMICS
COCHIN UNIVERSITY OF SCIENCE AND TECHNOLOGY
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SCHOOL OF MANAGEMENT STUDIES
COCHIN UNIVERSITY OF SCIENCE AND TECHNOLOGY

No: SMS..........................

Date 05-3-1999

DR.C.A.FRANCIS
PROFESSOR

CERTIFICATE

Certified that the thesis "A Study of Individual Investors in the Capital Market in Kerala" is the record of bonafide research carried out by Mr.Tomy Varghese under my guidance. The thesis is worth submitting for the Degree of Doctor of Philosophy in Social Sciences.

05/3/99
Dr. C.A. Francis
(Supervising Guide)

Dr. K. George Varghese
(Member, Doctoral Committee)

KOCHI - 682 022, KERALA, INDIA; Phone: Office: 5-55310; Res: 541197
Grams; Cusat, Kochi-22; Telex: 885-5019 CU IN; Fax: 91-484-532495

CONTENTS

LIST OF TABLES

LIST OF FIGURES

CHAPTER I

INTRODUCTION

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INTRODUCTION

Capital is a crucial factor in the development of an economy. The pace of economic development is conditioned, among other things, by the rate of capital formation. And capital formation is conditioned by the mobilisation and channelisation of investible funds. The role of the financial system is to channel funds from surplus sectors to deficit sectors. Facilitating such flows on a national level increases the level of investment and effective demand and thus accelerates economic development.

Capital market development has been closely related to an economy's overall development. At low levels of development, commercial banks tend to dominate the financial system. As an economy develops, the indirect lending by savers to investors tend to become more efficient. As economy grows further, specialialised financial intermediaries and securities markets develop. As securities markets mature, investors, especially individual investors, can invest their funds directly in financial assets issued by firms.

1.1 The Financial System

The financial system of any nation comprises within its fold the financial markets and their supporting institutions. The important financial markets, which exist in India, are the Treasury Bills market, Call Money market, Commercial Bills market, Mortgages market, Foreign Exchange market, Government Securities market and the Industrial Securities market.

In a market economy the financial system performs a number of important functions influencing the efficiency of the economy as a whole. Among the different sectors in the economy, households, generally, are surplus units, as they earn more than they spend and business firms are deficit units as they spend more than they earn.

The function of the financial system is to accept the excess of surplus units and lend it to deficit units. The financial system comprises the set of institutions, markets and relationships involved in borrowing and lending funds and that effects the volume and cost of credit (Jones, Frank 2).

1.2 Financial Markets

Trading in money and monetary assets constitute the activity in the financial markets. These are markets in which marketable securities are traded. Marketable securities are divided into money market securities and capital market securities, on the basis of their maturity.

Money market deals in near money and call money of a duration of upto 15 days, and bills which may run for three to six months or even upto one year.

Capital market, which deals in medium-term and long-term funds, has a direct bearing on the industrial growth and economic development of a state or a nation. Capital market exerts its influence in mobilising and allocating the nations capital resources among numerous competing uses. The efficiency with which this allocative function is performed determines in large part the overall growth and efficiency of the economy itself (Baumol, William 1).

1.3 Securities Market

Though capital market consists of all institutions, instruments and services, which pertain to long-term finance, the term has been used here to mean the industrial securities market.

The securities market is a major component of the capital market, dominated by industrial securities, consisting of two inter-linked segments, namely, the primary market, also called the new issue market, and the secondary market or the stock exchange. 'Stock Exchange' means any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. The stock exchange is a market place, like any other centralised market, where buyers and sellers can transact business in shares and securities at a given point of time in a convenient and competitive manner at the fairest possible price. Both segments enable new and existing enterprises to mobilise the required resources through public issues, rights issues and placement of shares under preferential offer.

Business enterprises can raise capital through the issue of ordinary shares, preference shares and debentures or bonds. Ordinary shares are ownership securities. Though investment in shares is permanent, transferability of shares makes them liquid. Preference shares are also ownership securities but carry a fixed rate of return as in the case of debentures.

Unlike ordinary shares and preference shares, debentures or bonds are creditor-ship securities with a fixed rate of return. The emergence of convertible debentures and partly convertible debentures is an important development of the 1970s. Convertible debentures can be converted into ordinary shares subject to the terms and conditions.

1.4 Investment in Securities

In finance, investment is the commitment of funds for the purpose of future returns. The term investment has been used here in the financial sense, which could ultimately result in investment in the economic sense. In the economic sense, investment refers to an increase in the stock of capital, which increases the productive capacity of a nation.

Investment may be defined as the purchase by an individual or institutional investor, of a financial or real asset capable of producing a return, over some future period. One area that has seen much activity and which falls within the core of the economic sector of the nation is the capital market.

1.5 Individual Investors

Investors may be institutions or individuals. In a capital based corporate democracy the investors are considered uncrowned kings. Individual investors are of strategic importance as households account for the lion's share of the gross savings in the country. The players and regulators in the capital market cannot afford to ignore the aspirations, attitudes, perceptions and expectations of individual investors.

A Reserve Bank of India (RBI) study of ownership of shares in 1978, covered 361 companies listed on various stock exchanges. The total paid-up value of Rs.1390.85 crore of the shares of these 361 companies were held by 30,16,000 accounts of which individuals held 99.3 per cent. Value-wise, individual holdings accounted for 37.58 per-cent, joint stock companies 33.77 per cent, financial institutions 25.68 per cent, government and semi-government bodies 1.49 per cent, and

1.48 per cent was held by trusts and charitable institutions (*RBI Bulletin*, Feb.1983, P.129).

An Industrial Development Bank of India (IDBI) study of 1986 gave the pattern of equity shares of 575 companies. Total paid-up capital of the 575 companies was Rs.2755.5 crore in terms of value. It was owned by 76,28,598 account holders. The largest number of accounts, 99.5 per cent, were held by individuals. In terms of value their holdings accounted for 36 per cent of total equity. Joint stock companies accounted for 25.9 per cent, financial institutions 22.6 per - cent, government and semi-government organisations 14.4 per cent, and 1.1 per cent was held by trusts and charitable institutions (*The SE Official Directory*, 9 (iii), P.11).

The number of listed companies in India has gone up from 2,225 in 1980 to over 9,000 in 1997. As on 31 March 1997, there were 9,890 companies listed on the Indian stock exchanges (*India 1998*, P.276). According to a survey by Securities and Exchange Board of India (SEBI) in 1996, there are more than 17 million individual shareholders and 72 per cent of them are in the middle income group.

Table 1.1

Number of Individual Investors in India

Year	No. of Individual Investors(in Lakhs)
1980	24
1985	60
1990	90
1992	130
1994	160
1996	190

Source: Gupta, *Indian Shareowners*, Research Monograh, P.15.

The number of share-holding population has been increasing in India. This increase can result in the transformation of trading capital to industrial capital. Though India witnessed the spread of the equity cult in the 1980s, wild gyrations and extreme volatility in stock prices do cause worries.

1.6 State-wise Share-owner Distribution.

Among the states, Maharastra accounts for nearly one third of India's share owning population. A comparison of state-wise distribution of shareowners for 1984 and 1992 shows the emerging trends in the Indian capital market.

Table 1.2 shows that the share of the top 5 states, viz., Maharastra, Gujarat, West Bengal, Tamil Nadu and Karnataka, came down from 82.6 per cent in 1984 to 74.7 per cent in 1992. Gujarat stands as an exception, which increased its percentage share from 16.2 in 1984 to 19.4 in 1992. The share-holding habit in Gujarat has spread among the people of small towns and villages. In Kerala too, the equity cult has been spreading to the villages (*Prime* database).

Table 1.2 also shows the shareowner incidence in India, ie., the number of shareholders per 100 population. The highest shareholder incidence of 5.88 per cent is found in Gujarat followed by Maharastra (5.12). In Kerala, the shareholder incidence, which was 0.09 in 1984 has gone up to 0.74 in 1992.

Table 1.2

State-wise Share-owner Distribution

Sl. No	State/Union Territory	Population as per 1991 Census	No. of Individual Share owners	Share-owner incidence (No of shareowners per 100 persons.	
				1984	1992
1.	Gujarat	4,11,74,343	24,21,225	1.43	5.88
2.	Maharashtra	7,87,48,215	40,31,225	1.93	5.12
3.	W.Bengal	6,79,82,732	11,78,275	0.57	1.73
4.	Tamilnadu	5,56,38,318	6,67,313	0.39	1.20
5.	Karnataka	4,48,06,468	4,99,463	0.31	1.11
6.	Punjab	2,01,90,795	1,83,463	0.17	0.91
7.	Rajasthan	4,38,80,640	3,66,350	0.20	0.83
8.	Haryana	1,63,17,715	1,27,988	0.16	0.78
9.	**Kerala**	**2,90,32,828**	**2,14,525**	**0.09**	**0.74**
10.	Andhra Pradesh	6,63,54,559	4,00,663	0.12	0.60
11.	Uttar Pradesh	13,90,31,130	5,39,998	0.10	0.39
12.	Madhya Pradesh	6,61,35,862	2,31,075	0.07	0.35
13.	Bihar	8,63,38,853	1,90,288	0.03	0.22
14.	Assam	2,22,94,562	44,363	0.02	0.20
15.	Himachal Pradesh	51,11,079	10,425	0.05	0.20
16.	Jammu & Kashmir	77,18,700	13,263	0.02	0.17
17.	Orissa	3,15,12,070	38,913	0.02	0.12
18.	Delhi (UT)	93,70,475	10,37,425	4.60	11.07
19.	Chandigarh (UT)	6,40,725	66,225	2.40	10.34
20.	Goa	11,68,622	33,163	0.27	2.84

Source: Gupta, *Shareowners' Geographic Distribution*, P.87.

1.7. Investors in Kerala

The failure of the private financiers (the notorious 'Blade Companies') in the 1980s and the 'Get-Rich Quick' schemes like the goat farms and teak plantations in the early 1990s ruined many investors in Kerala. Investment in gold and silver also was not lucrative as they expected. It coincided with the rampant speculation and fabulous gains of some investors in the capital market in the 1980s.

Though certain commercial banks in Kerala started 'Investment Forums', and certain groups 'Investment Clubs', the State lacked a mechanism to make the people aware of the opportunities that existed in the capital market. The establishment of the Cochin Stock Exchange (CSE) in 1978 bridged this gap to a considerable extent. Yet, statistics in the 1980s revealed that investment in corporate securities by the average Keralite was lower than the national average.

1.8 Statement of the Problem

Kerala has a large reservoir of small investors belonging to the middle class households. It has the nation's most literate population and the highest reach of print media. Kerala has a very good financial infrastructure and access to large volume of NRI funds. The savings rate in Kerala is very high compared to other states.

Though investors and investor behaviour differ, the ultimate goal of an investor is attaining high return. There are different investment avenues, but the problem has been selecting the most remunerative and suitable of them. Some are simple, others complex, some guarantee fixed returns while others involve high risk, some investments are appropriate for one type of investor and another may be suitable for another investor.

The present study attempts to understand the behaviour of individual investors in the capital market in the State of Kerala. An equity cult has been developing in the State since the early 1980s and the study covers the period from 1980 to 1998. This period witnessed extraordinary growth in the activities in the capital market. This period also witnessed dramatic fluctuations in investor behaviour. The exuberant and collective enthusiasm of investors often evaporated into spells of indifference. Why the investors rushed in and rushed out of the market has not been comprehensively accounted for.

1.9 Importance of the Study

The growing popularity of the capital market investment has been evident from the continuous increase in the number of individual investors. Investors are in the capital market for high rewards. At the same time, they play an important role in the industrial development of a nation. The firms seeking to raise capital from the market cannot ignore the interests of the investors.

Individual investors constituting the majority have an indispensable and strategic role in the growth and smooth functioning of the capital market and in ensuring capital flows into the most efficient hands.

Kerala seemed to have everything going in its favour to build the largest number of investors in industrial securities. However, very little data are available on the behaviour of individual investors in Kerala. Hence this study, the first of its kind for Kerala, attempts to explore the behaviour of individual investors in the capital market.

Under the circumstances, an analysis of investor behaviour, a review of capital market development and an evaluation of the market performance of companies are of considerable relevance.

1.10 Objectives of the Study

The study seeks to analyse the characteristics and behaviour of individual investors in the capital market in Kerala. The objectives of the study, specifically, are:

1. To get a profile of Individual Investors in the Capital Market in Kerala.
2. To identify the factors influencing the investors' demand preferences for assets.
3. To analyse the attitudes and perceptions of Individual Investors.
4. To estimate the Returns on Investment.
5. To understand the problems faced by investors with respect to the capital market.

1.11 Methodology

This study seeks to analyse the attitudes and perceptions of individual investors, capital market functioning and the market performance of corporates in the State of Kerala.

Both primary and secondary data have been used for the study. Primary data were collected from a sample of around 300 investors with the help of a survey to get a profile of individual investors, to analyse their attitudes and perceptions, and to understand the problems faced by them. The sample households were drawn from 7 of the 14 districts in the State with the help of active stock - brokers. The districts selected were Trivandrum, Kottayam, Ernakulam, Idukki, Alleppey, Trichur and Calicut. Ernakulam was selected by virtue of the existence of the Cochin Stock Exchange and the highest shareholder density there. Trichur, Alleppey, Kottayam and Idukki are the adjacent districts and shareholder densities in these districts also have been relatively high because of their proximity to the Exchange. Trivandrum and Calicut districts have also been selected in terms of shareholder density to represent the northern and southern parts of Kerala.

Respondents from urban, semi-urban and rural areas were included to ensure balance in representation. The survey covered a cross section of investors and the respondents were classified into different categories on the basis of income, profession, educational status, geographical area, sex and age.

Besides, information pertaining to the various problems faced by the investors and the intricacies of the market mechanism was collected from experts in the field.

The secondary data were collected from reports, seminar papers, books, journals, Stock Exchange reports, RBI Bulletins and government publications. The general information required has been obtained from secondary sources. Detailed information pertaining to the development of capital market also has been collected from published materials.

To estimate the returns on investment and the market performance of companies, 60 companies whose shares were widely held by the respondents were selected. To identify and verify the companies, the list was cross-checked with the daily quotations of the CSE for the last several years and the list was narrowed down to 45.

These companies were classified into three categories, viz.: (a) Kerala based companies listed on the Cochin Stock Exchange (CSE) (b) Companies based outside Kerala and listed on the CSE and (c) Companies not listed on the CSE but permitted to trade their shares there. Internal Rate of Return (IRR) for each category was estimated separately.

The formula used is:

$$P_0 = \frac{D_1}{(1+r)} + \frac{D_2}{(1+r)^2} + \ldots + \frac{D_n}{(1+r)^n} + \frac{P_n}{(1+r)^n}$$

Where

P_o - the acquisition cost

$D_1, D_2 \ldots D_n$ - the cash dividends received in respective years

P_n - the terminal price realised

r - the IRR per rupee per annum.

The study employed simple statistical techniques such as averages, percentages, mean deviation and standard deviation for analysis and organisation of the information collected from all sources. The analysis of the data was also carried out with the help of investment ratios such as return on equity and price-earnings ratio (P/E ratio).

The present study being exploratory in nature, does not advance any hypothesis.

1.12 Limitations of the Study

There are various investment avenues in the capital market. However, the study confines only to investment in shares and debentures.

The general reluctance of people to reveal data on income and investment, made the task of gathering data somewhat difficult.

1.13 Scheme of the Report

The study is presented in seven chapters. After presenting the research problem, nature, scope and objectives of the study in the introductory chapter, the second chapter presents a review of the important studies on capital market, vis-à-vis stock market operations, stock market efficiency, stock pricing, investor behaviour, etc.

Chapter three gives an overview of the major features of development of the Indian Capital Market. Chapter four presents a brief sketch of the capital market environment in Kerala, its potential for industrial securities, the role of Cochin Stock Exchange and a profile of individual investors.

The attitudes and perceptions of individual investors are analysed in detail in Chapter five. This chapter also examines the important factors influencing investors' demand preferences for assets. Estimates of Returns on Investment are presented in Chapter six. Chapter seven presents the conclusions and recommendations of the study.