

PRE OPEN SESSION IN INDIAN STOCK EXCHANGES: A VIEW

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INTRODUCTION

Secondary market is that segment of the capital market where the securities are traded. It is an open auction market where buyers and sellers meet and evolve a competitive price for the securities. This market provides sufficient marketability and price continuity for shares so necessary for the needs of the investors. The reflection of trade value of an asset in its price is an indicator to the existence of an efficient market. In the process of true value of an asset in its price, market functioning focusing and introducing new initiatives to stabilize the price in the early minutes of trading. Indian stock market, especially the National Stock Exchange led the market in the process of price stabilization in early minutes of trading and introduced pre open session.

PRE OPEN SESSION:

The pre-open session duration is 15 minutes i.e., from 9:00 am to 9:15 am. The pre-open session is comprised of order collection period and order matching period. After completion of order matching there is silent period to facilitate the transition from pre-open session to the normal market. Accordingly, Normal Market / Odd lot Market and Retail Debt Market will open for trading after closure of pre-open session i.e. 9:15 am. Pre-open session shall comprise of two sessions viz.

- ◆ Order Collection Period.
- ◆ Order Matching Period.

The Securities and Exchange Board of India (SEBI) is reviving the practice of pre opening session for share

trades, and has asked stock exchanges to put systems in place for it. To begin with, introduced on a pilot basis, and will be applicable only for shares in the Bombay Stock Exchange's index SENSEX (Sensitivity Index) and National Stock Exchange's index NIFTY (National Index of Fifty). Most stock exchanges in the world over have a Pre Open Session. The BSE and NSE used to have a Pre Open Session which was discontinued some years ago after complaints that some groups of influential brokers were frequently manipulating the opening prices by placing bids at arbitrary prices. Brokers and dealers have been spread the trouble of coming to office even earlier for the Pre Open Session, as it will be for 15 minutes between 09:00 am to 09:15 am. Of this, eight minutes is allowed for order entry, order modification and order cancellation, four minutes for order matching and trade confirmation and remaining 3 minutes is for the buffer period, to facilitate the transition from Pre Open Session to the normal market, according to the Securities Exchange Board of India circular. The session shall close during the last one minute any time between the 7th and 8th minute of the order entry. A price band of 20% shall be applicable on the securities during the Pre Open Session, which means that the bid or offer price cannot be more or less than 20% of the previous day's closing price.

ORDER COLLECTION PERIOD:

The order collection period is defined as the timing of Pre Open Session. During this period orders can be

entered, modified and cancelled. Both limit and market order will be allowed. The information like indicative equilibrium / opening price of scrip, total buy and sell quantity of the scrip, indicative NIFTY Index value & per centage change of indicative equilibrium Price to previous close price will be computed based on the orders in order book and will be disseminated during pre-open session.

ORDER MATCHING PERIOD:

Order matching period will start immediately after completion of order collection period. Order will be matched at a single (equilibrium) price which will be open price. The order matching will happen in following sequence.

- Eligible limit orders will be matched with eligible limit orders
- Residual eligible limit orders will be matched with market orders
- Market orders will be matched with market orders.

During order matching period order modification, order cancellation, trade modification and trade cancellation will not be allowed. The trade details will be disseminated to respective members before the start of normal market. The pre open session is introduced initially for the SENSEX and NIFTY components. In case of any change in composition of the index, the incoming stock(s) will be incorporated for computation of the market opening price in the pre open session. The outgoing stock(s) will continue to be part of the pre open session. The pre open session shall be conducted for duration of 15 minutes, i.e. from 9:00am to 9:15 am. The pre open session schedule will be as follows.

SESSION	TIME	ACTION
Order Collection Period	9.00am to 9.07/08 am	-Order addition /modification /cancellation -Random stoppage between 7th and 8th minute -No trade are executed -Dissemination of indicative price, matchable quantity at the indicative price & indicative index
Order Matching & Confirmation Period	9:08am -9:12am	-No order addition/modification/cancellation -Opening price determination, order matching and trade confirmation
Buffer Period	9:12am -9:15am	-To facilitate transition between pre-open and continuous trading session

DETERMINATION OF MARKET OPENING PRICE:

The market opening price will be determined through volume maximization logic as described below -

- ❖ Price at which maximum quantity is tradable (If there is more than one price that meets the above criterion, then we go to the next step)
- ❖ Price at which absolute order imbalance (difference in cumulative buy & cumulative sell quantity at that price) is minimum. (If there is more than one price having same absolute order imbalance quantity, then we go to the next step.)
- ❖ Price which is closest to the previous day's closing price. In case the previous day's closing price is the mid-value of pair of prices which are closest to it, then the previous day's closing price itself will be taken as the market opening price.

UNEXECUTED ORDER:

All orders that remain unexecuted at the end of the pre-open session will be shifted to the order book of the continuous trading session retaining the original time

stamp. Limit orders will be moved to the continuous session at the limit and market orders will be moved as limit orders at the opening price. If the opening price has not been discovered, then all the orders will be shifted to the order book of the continuous trading session following price time priority. The price of the first trade in the continuous trading session will be the opening price for the stock.

INFORMATION DISSEMINATION:

The following information will be disseminated to the market at regular intervals during the order entry period pre-open session. Indicative market opening price, populated in the 'Last Traded Price' field. Matchable quantity at the indicative market opening price, populated in the 'Last Traded Quantity' field. If the indicative opening price/matchable quantity at the indicative opening price is not available then the 'LTP'/LTQ' field is left blank. Indicative values of SENSEX and other BSE indices. Total buy/sell depth of the book will be populated in the 'Buy/Sell depth' fields. Percentage change in the indicative price from the previous day's closing price. High/Low prices will be disseminated based on the indicative opening prices. The 'open' field in the Bombay Online trading system will be populated only when the actual opening price has been determined in the order matching and confirmation period. The 'Close' field will display the previous day's closing price. The market depth would display:

- ◆ The indicative opening price + next best 4 bids and offers. If the indicative opening price is not determined, then the best bids and offers will be displayed.
- ◆ The cumulative quantities at each of these price points.
- ◆ Market order quantity will be added to the best

available price point.

Example of the market depth display.

- ◆ Price Bands: A uniform price band of 20% will be applicable on all the participating stocks during the pre-open session. In addition to the pre-open trading session, we would like to inform all trading members that certain new features are being introduced in the Bombay Online Trading Trader Work Station, given as below -
- ◆ In the Touchline, LTQ (Last Traded Quantity) has been enabled for profiling. In the DLOAD, Pre-Open Call Auction scrips are available that can be directly loaded in the Touchline.

SEBI has banned 'iceberg' orders in the Pre Open Session. These are orders where only a part of the bid or offer is visible on the screen. Brokers use the iceberg facility while executing large orders, so that other traders do not try to move the price against them. Limit orders and market orders shall be entered during the Pre Open Session and both shall be taken into consideration for deciding the "Equilibrium Price", which is the opening price for the day. The Equilibrium Price shall be the price at which the maximum volume is executable.

DETERMINATION OF EQUALIBRIUM OPENING PRICE:

The opening price shall be determined based on the principle of demand supply mechanism. The Equilibrium Price will be price at which the maximum value is executable. In case more than one price meets the said criteria the Equilibrium Price will be the price at which there is minimum order imbalance quantity (unmatched order quantity). The absolute value of the minimum order imbalance quantity, the Equilibrium Price will be the price closest to the previous day's closing price is the mid-value of pair of prices which are

closest to it, and then the previous day's closing price will be the adjustable closing price or the base price.

Both limit and market orders shall reckon for computation of Equilibrium Price. The Equilibrium Price determined in Pre Open Session is considered as open price for the day. In case of only market orders exist both in the buy and sell side, then order shall be matched at previous day's closing price or adjusted closing price/ base price. Previous day's close or adjusted close price/ base price shall be the opening price. In case of no price is discovered in Pre Open Session, the price of first trade in the normal market shall be the open price. In case more than one price meets the said criteria, the Equilibrium Price shall be the price at which there is minimum unmatched order quantity. The SEBI circular said "Further in case more than one price has some minimum order imbalance quantity, the Equilibrium Price shall be the price closest to the previous day's closing price." The circular said. At the time of order execution limit orders shall be given priority over market orders the circular said, if the price is not discovered in the Pre Open Session, then the orders entered in the Pre Open Session will be shifted to the order book of the normal market following time priority. The price of the first trade in the normal market shall be the opening price.

UNMATCHED PRICE:

All outstanding order will be moved to the normal market retaining the original time stamp. Limit orders will be at limit price and market orders will be at the discovered Equilibrium Price. In a situation where Equilibrium Price is discovered in the Pre Open Session, all market orders shall be moved to normal market at previous day's close price or adjustable close price/ base price following price time priority.

RISK MANAGEMENT:

All orders received in Pre Open Session shall be validated at the applicable margins for sufficiency of available capital prior to acceptance of the orders. If the available capital of member is insufficient to cover the margin requirement of the order placed, the same shall not be accepted for the Pre Open Session. The existing risk management framework shall be applicable for trades resulting from Pre Open Session and trades during the normal market share.

PRE-OPEN CALL AUCTION SESSION:

The way they go about doing this is instead of executing trades right from the get go, they take all orders, and then arrive at an Equilibrium Price. The Equilibrium Price is the price at which the maximum number of shares can be traded based on the demand and supply quantity and the price. Let us consider this example:

BUY ORDER	BUY PRICE	CUMULATIVE	SELL PRICE	SELL ORDER	CUMULATIVE
1	54	1	54	5	15
2	53	3	53	4	10
3	52	6	52	3	6
4	51	10	51	2	3
5	50	15	50	1	1

PRE OPEN CALL AUCTION DEMAND AND SUPPLY:

In this example one can see various buy and sell orders at different price levels. The green side is the buy side which shows that there is a bid for 5 shares at Rs. 50, 4 shares at Rs. 51, and so on till Rs. 54 at which there is just demand for 1 share. On the red side you can see that you can sell 5 shares at Rs. 54, but only 4 at Rs. 53, 3 at Rs. 52 and so on. There is a cumulative column at

the end of both sides which shows you the total number of shares that can be bought or sold at any given price.

One can see this:

At Rs. 50 there are 15 buyers but just one seller so only 1 share will be traded. At Rs. 51 there are 10 buyers but only 3 sellers, so only 3 shares will be traded. At Rs. 52 there are 6 buyers and sellers so 6 shares will be traded. At Rs. 53 there are 10 sellers but only 3 buyers. And at Rs. 54 there are 15 sellers but only 1 buyer. So, in our example at the end of the price discovery phase the price will be determined at Rs. 52, and the orders that can be executed at that price will be executed. The other orders can be carried forward to trade in the regular

market.

In this example, if the normal method of determining price would have been used then some trades would have happened on Rs. 54, and Rs. 53 in our example, and by determining the price at an auction like this at least theoretically the exchange is smoothing out some of the volatility that occurs in the opening moments of the market.

If there are more than two prices at which the demand supply matches then they see which of them has the minimum imbalance, and use that as the price. If both the prices create equal imbalance, then they look at the price which is closest to the last closing price and make that the Equilibrium Price

Company Name: SBI (Pre Open Session)

Week (02/05/2011 to 13/05/2011)

(Price in Rupees)

Sl.No.	Date	Previous Day Closing Price	Indicative Equilibrium Price	Opening Price	%Change
1	02/05/2011	2804.60	2810.00	2810.00	0
2	03/05/2011	2692.70	2680.10	2680.10	0
3	04/05/2011	2583.70	2691.90	2591.90	-3.71
4	05/05/2011	2615.80	2615.00	2615.00	0
5	06/05/2011	2602.40	2603.00	2603.00	0
6	09/05/2011	2649.90	2657.00	2657.00	0
7	10/05/2011	2623.25	2620.60	2620.60	0
8	11/05/2011	2627.00	2637.40	2637.40	0
9	12/05/2011	2675.00	2659.00	2659.00	0
10	13/05/2011	2641.45	2644.40	2644.40	0

INTERPRETATION:

It is observed that the opening price and indicative equilibrium prices are equal. Normal day trading price starts with high than that of previous day's closing price. And on 3rd may the normal day price starts with low. And on 4th may the indicative equilibrium price is

Rs. 2691.9, and opening price is 2591.9. There is a difference of Rs. 100(2691.9-2591.9). This is because of the SBI quarter results. On 3rd may SBI announced its results, and SBI want to raise the interest rates to 25 BPS and NPA also increased. So, with that result the price value came down. The share price is totally

depends on the market information. Fluctuations in the prices will be depending on the market information.

CONCLUSION:

The initiatives of stock exchanges are aimed to build confidence of investors who invests in the stocks. In the process of new initiatives the pre-open session also introduced and succeeded in getting positive results. The pre-open session applied to Index shares and finding equilibrium price which will be the opening price of the stock. Such stock price helps the investors to trade without much volatility during the market opening time. The initiative called pre-open session by the stock exchanges in Indian much be extended to many other actively traded shares to increase the confidence of the investors.

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