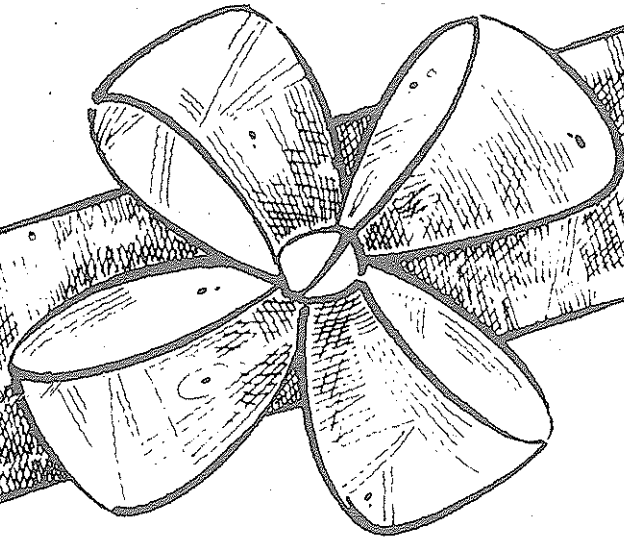


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The Stock Exchange
Bombay
Seminar on
Capital Markets
Problems and Prospects
4th February, 1988
at Taj Mahal Hotel,
Bombay



SEMINAR DOCUMENTATION.

THE STOCK EXCHANGE, BOMBAY

Seminar

on

Capital Markets - Problems

and

Prospects.

PROGRAMME

Date : Thursday, the 4th February, 1988.

Venue : Ball Room, Taj Mahal Hotel, Apollo Bunder, Bombay-400 039.

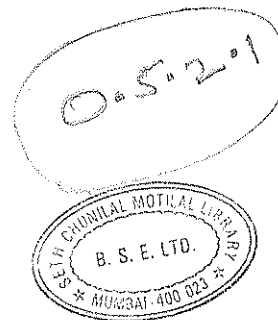
Time : 9.00 A.M. to 5.30 P.M.

9.00 A.M.

Delegate Registration.

9.30 A.M. to 10.30 A.M.

1. Welcome Speech by the President of the Stock Exchange. **Shri Mahendra N. Kampani**
2. Lighting of Deepmala by the Chief Guest to mark the Inaugural Ceremony.
3. Key Note address and release of souvenir by the Chief Guest.
4. Vote of thanks by the Vice-President, **Shri G. B. Desai.**



10.30 A.M. to 11.00 A.M.

TEA BREAK.

11.00 A.M. TO 01.30 P.M.

FIRST TECHNICAL SESSION :-

Subject : Primary Market

Chairman : Shri S. S. Nadkarni
Chairman & Mg. Director,
Industrial Development
Bank of India.

Faculty :

1. **Shri H. T. Parekh** Stock Market - yesterday,
Chairman, today, and tomorrow.
Housing Development
Finance Corporation Ltd.
2. **Shri S. A. Dave** Role of the proposed
Executive Director National Securities Board
Industrial Development
Bank of India
3. **Shri N. J. Jhaveri** Introduction of new
Dy. Managing Director corporate instruments to
The Industrial Credit & widen the base of the
Investment Corp. of primary market.
India Ltd.
- 4) **Shri Bhupen C. Dalal** Broker Underwriting -
Vice-Chairman & Evaluation &
Mg. Director, Performance.
Champaklal Investment &
Financial Colsultancy Ltd.
5. **Shri Nimesh N. Kampani** Marketing Issues, Rural
Managing Director, mobilisation and Broker
J. M. Financial & Underwriters' Role.
Investment Consultancy
Services Pvt. Ltd.
6. **Shri Arun Agarwal** Post Issue formalities.
Managing Director,
Mas Services Pvt. Ltd.
7. **Shri Bhagirath Merchant** Mobilisation of resources
Chairman, from NRIs.
Pam Financial Consultants
Pvt. Ltd.
8. Question - Answer session.

01.30 P.M. to 02.30 P.M.

LUNCH BREAK

02.30 P.M. to 05.30 P.M.

SECOND TECHNICAL SESSION :-

Subject : Secondary market

Chairman : Shri M. J. Pherwani
Chairman
Unit Trust of India

Faculty :

1. **Shri Mahendra N. Kampani** Development of Secondary
President Market - 3 tier Market.
The Stock Exchange, Bombay.
2. **Shri Philip Thomas** Need for Stock Holding
Chairman Corporation.
Stock Holding Corporation
of India Limited.
3. **Shri M. R. Mayya** Regulation of the market
Executive Director and investor protection.
The Stock Exchange,
Bombay.

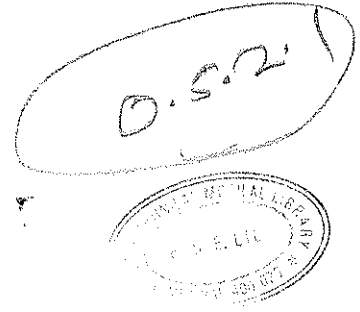
4.00 P.M. TO 4.15 P.M.

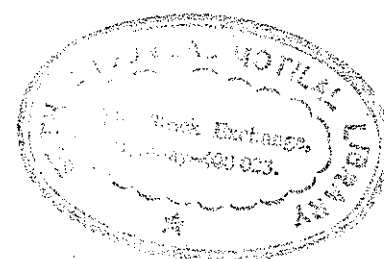
TEA BREAK

4. **Shri Ram Piparaiya**
Stock Analysis and
Managing Director, Portfolio Management.
Aridhi Investment
Consultants Pvt. Ltd.
5. **Shri P. G. Ruiya** Free Trading in specified
Director, share with special
The Stock Exchange, reference to liquidity.
Bombay
6. **Shri Shirish Dave** Perception of a stock
Member, broker.
The Stock Exchange,
Bombay
7. **Shri Vallabh Bhansali** Not only Investor
Director, Education.
Enam Financial Consultants
Pvt. Ltd.
8. Question - Answer session.

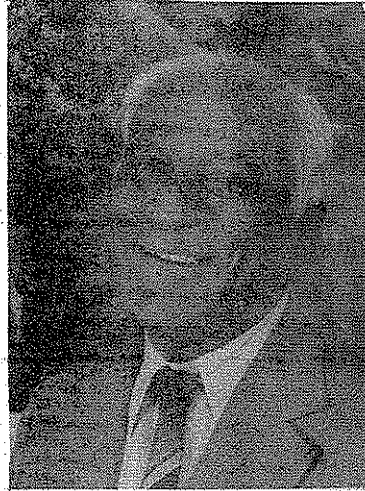
05.30 P.M.

Vote of thanks by **Shri Upendra M. Dalal**
Director, The Stock Exchange, Bombay.





Mr. H. T. Parekh



Shri H. T. Parekh

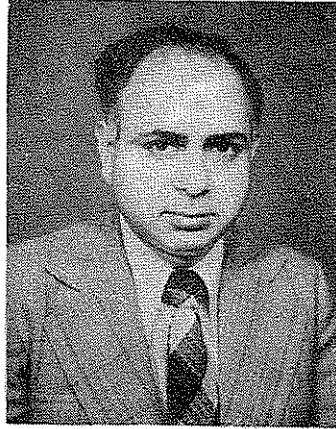
Shri H. T. Parekh is a Chartered Accountant and holds a B.Sc. degree in Banking & Finance from the London School of Economics. For the first 3 years of his career he was a lecturer in Economics with St. Xaviers College, Bombay. For 20 years he worked with a prominent brokers firm, after which he joined I.C.I.C.I. then newly formed, as Deputy General Manager, in 1956. He rose to ultimately become its Chairman in 1976. He promoted Housing Development Finance Corporation Ltd. (H.D.F.C.) in 1977 and presently is its Chairman. He has written several books such as 'The Bombay Money Market. 'The Future of Joint stock Enterprise in India,' 'Management of Industry in India', 'The Story of a Development Bank' and others, including 2 books in Gujarati - 'Hirane Patro' & 'Hirane Vadhu Patro'.

Dr. S. A. Dave



Dr. S. A. Dave

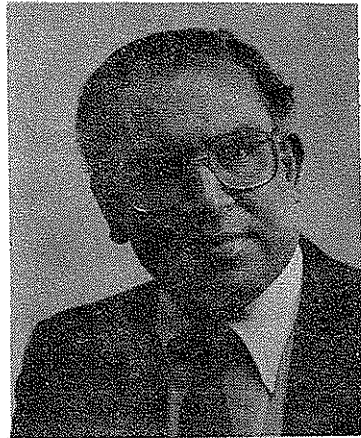
Dr. Dave, a Ph.D in Economics from Bombay University, has also obtained a Masters Degree from the University of Rochester, USA. He started his career in 1960-61 as a Statistical Assistant with the Dept. of Economics, Bombay University. Since May 1973 he has been working with IDBI and from May 1978 onwards he has been appointed as Executive Director with IDBI. Besides representing India at various international conferences and seminars, he has also lectured in several national and international training programs. He is a member of several committees and on the Board of several Public and Private Sector Companies. He is also a Director on the Board of the Bombay Stock Exchange.



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Mr. N. J. Jhaveri



Mr. N. J. Jhaveri

Mr. N. J. Jhaveri is a M.Sc. in Economics from the London school of Economics. He started his career teaching graduate and post graduate classes in Gujarat, after which he joined the National Council for Applied Economic Research. Subsequently he spent nine years with the Reserve Bank of India's Economic Research Department, from where he shifted to ICICI as its chief economist. He is presently Deputy Managing Director of ICICI. He is also editing the International Journal of Development Banking.

Mr. Bhupen Dalal



Mr. Bhupen Dalal

He is a Commerce graduate from Sydenham College, Bombay. After a short stint with a London broking firm he joined the family business and has today expanded and diversified to cover a broad range of products. Besides being a director on the Board of many reputed companies, he is also the Vice chairman and Managing Director of Champaklal Investment and Financial Consultancy Ltd., a leading private sector Merchant Banking Organisation. he has also specialised in Non-Resident investment and has promoted 3 joint venture companies abroad. He is also an active Rotarian and associated, as trustee, with several charitable institutions.

BROKER UNDERWRITERS

EVALUATION

&

PERFORMANCE

In India, underwriting of Capital Issues is restricted to Financial Institutions, Commercial banks and Stock Brokers. The rules provide, that investment or finance companies, with requisite experience may be permitted to underwrite, but so far the Stock Exchanges have not considered them acceptable except for two or three companies.

Under provisions of the Companies Act 1956, Directors of a Company are required to make a statement, in the prospectus for public issue, that in their opinion, the resources of the underwriters are sufficient to discharge their underwriting obligations. It is easy to make a statement to that effect for underwriting arrangements made with Financial Institutions and Banks whose resources are known and published. The problem is about making such a statement for the broker underwriters.

The primary market in India has undergone a tremendous change in the last two decades, the average size of an issue being considerably higher than what it was a few years ago.

It has been a practice to judge the broker underwriters' resources by their "placing" capacity, or in other words their ability to continuously "procure" subscriptions

and therefore is not strictly limited to their owned funds.

From the view point of the company's management, and the Merchant Bankers, (depending on the state of the primary market), a considered decision has to be made in deciding the proportion of Institutional Underwriting vis-a-vis Broker Underwriting. The former category has the "money power" to redeem its commitment by subscribing to the devolvement. They are considered "negative underwriters", since they have no significant capacity to popularise, market or help in placing of the shares. The broker-underwriter on the other hand has no significant owned or liquid funds, to take up the devolvement in their own books in the event of under-subscription, but play a very important role in the marketing of securities. The role of broker underwriters is therefore very important in the successful placing of securities with the general public. In normal times, a broker-underwriter would have performed much beyond his underwriting commitment.

The broker underwriter places the securities through one or more of the following means:-

1) **DIRECT ADVICE TO CLIENTS** :

This would be limited at the most to a few hundreds since the capacity and manpower of an average Indian Broker is limited.

2. **SUB-BROKER NET WORK** :

Major underwriters have been able to build up an effective network of sub-brokers both on part time and full time basis, whose individual efforts add-up to a significant total for the underwriter.

3. **INCENTIVES** :

Many brokers have resorted to winning over clients by offering cash incentives over the counter for investors submitting forms with their rubber stamp.

4. MAILING TO THEIR OWN CLIENTS AND BLIND MAILING :

Brokers have a regular mailing list of their own but in larger issues resort to blind mailing by buying lists of applicants in recent successful public issues. This method, though necessary until alternate methods are evolved, has of late outlived its usefulness and has become counter productive. There is a tremendous amount of wasteful expenditure on mailing and particularly duplication in today's market, but it cannot be discarded until an alternative is found.

The job of an effective Merchant Banker is to advise his client to arrive at a mix between institutional and broker-underwriting and especially to allocate the extent of underwriting for individual firms. In a booming market, there is a scramble by brokers to get their share of underwriting, and the Merchant Bankers are in a happy position of having the upperhand of distributing largesse with a feeling that they have handed over a cake. The role is totally reversed when it comes to a bear market phase like the one prevailing at present.

A shrewd and knowledgeable underwriter commits his underwriting only when he is confident of placing them and would commit an amount that is far below his expectations. They, therefore perform a very important function of providing the market pulse and their enthusiasm or lukewarm attitude gives the first indication of the likely fate of the issue and investor response.

I remember a senior executive of the apex financial institutions once branding the "brokers" as fair weather friends, and admonished them for not doing their national duty of underwriting and took pride in his own courage in committing his institution for underwriting in spite of a bad market. I could only counter him by saying that a broker-underwriter takes a commercial decision, and will underwrite solely on his judgement of investor response. I offered to underwrite Rs. 1 lac in every issue in which he would personally subscribe to a token of 100 shares and reminded him that he was committing the institutional funds which has the resources or long term holding capacity whereas for the broker who has limited resources is personally affected by the quality of his own judgement, not necessarily quality of the project or its profitability, but on the success or failure of the issue.

at that moment of time.

During the recessionary period of 1962-1963 many issues such as G.S.F.C. and Herdillia Chemicals hardly evoked 3% to 7% response, yet they are successful companies with excellent track record, whereas shares of some of the heavily oversubscribed issues are unsaleable. The response to issues is generally related to the prevailing mood and state of the secondary market.

Underwriting is a specialised function and not every broker is necessarily a good underwriter. He has to possess an effective network, organisation, and above all experience of having witnessed at least one or two ups and downs of the primary market. It is sad to find that the authorities insist on wider distribution of underwriting pattern. Recently several new stock exchanges have been established and many new and inexperienced members do not realise the financial implications of an underwriting commitment. They merrily accept all sorts of offers and earn commissions in good times, and blatantly default when it comes to devolvement. In view of the time constraints and cumbersome procedure involved, companies find it difficult to enforce their claims. The Merchant Bankers, also advise their clients to take a soft line and evolve settlements, since they are in the market all the time and would not like to burden the underwriters.

The authorities like Stock Exchanges and Merchant Bankers in the overall interest of the primary market must ensure that defaulters are not offered underwriting in future issues and thereby establish certain ethics and code of conduct. The Merchant Bankers have to spend some time in analysing performance of various brokers and their ability or desire to meet their commitments in the undersubscribed issue, while allocating the quantum of underwriting between different brokers. A definite "Weightage" has to be given to regular underwriters in good times, to compensate for their losses in difficult times. It is unfortunate that the underwriting offers, get diluted to small amounts in "hot" issues when the Merchant Banker wishes to "oblige" large number of underwriters wanting to have a cake only when the market is favourable.

The underwriting pattern of share brokers has seen a drastic change in the last 25 years. Indian explosives Ltd., a quoted company with shares hovering around

Rs.10/- made a public issue by prospectus for finance expansion on 6th November, 1987.

A total of just 6 brokers underwrote a massive amount of Rs. 1.53 crores with some brokers underwriting as much as Rs. 48 lacs. Underwriting Rs. 48 lacs in 1967 if compared in real terms in today's context is a phenomenal amount and that too at a time when the age of premiums, network of sub-brokers and mass scale mailing did not exist.

Indian Explosives Limited issued special series of "A" class shares for their fertiliser project, which had no dividend entitlement for a few years, to coincide with the returns on the new unit, had an underwriting support of only 6 brokers, whereas there were as many as 263 brokers-underwriters in the recent public issue of Indo Gulf Fertilisers.

The broker underwriter has a very vital role to play in the primary market of this country and in the interest of a healthy and vibrant market, it is necessary for the Merchant Bankers to impose discipline on them, by evolving a list of approved underwriters, based on their experience, performance, and more particularly their experience in meeting their commitments.

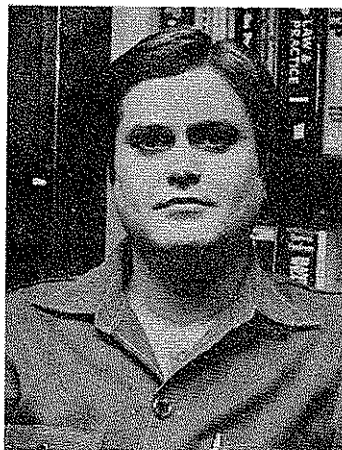
The Stock Exchanges have to be particularly vigilant in holding up permissions to brokers to underwrite, if they have not fulfilled their old commitments.

In conclusion, I would like to stress that the financial services industry will continue to grow, in spite of the present "temporary" sluggishness of the Capital Markets which is normal and cyclical. Broker-underwriters have a vital role to play in effective marketing and distribution, where they have a distinct edge over financial institutions and banks. Their initial reaction to underwriting offers gives the first and important clue to the Company and their Merchant Bankers of the likely investor response. A healthy code of conduct and internal discipline could result in a continued growth of business and income to the brokers.

I would particularly like to welcome the Finance Minister's announcement in evolving a "safety net" for broker-underwriters. It is contemplated that financial

institutions would bail out underwriters, at predetermined rates, in case of devolvement in certain selected issues. Brokers would be happy to underwrite larger amounts, and thereby make extra marketing effort, on a feeling that if their judgement goes wrong, there will be a floor price for the shares devolved and their losses are limited. In the long-run, financial institutions too will find that their overall devolvement will considerably decrease if the brokers take advantage of the safety net arrangement and aggressively underwrite and market larger issues.

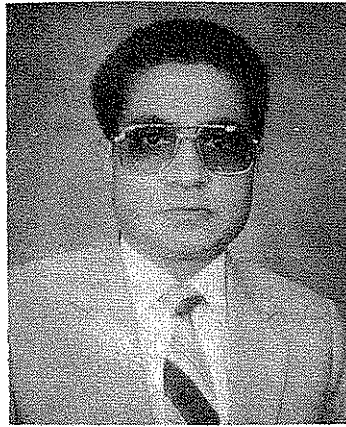
Mr. Nimesh Kampani



Mr. Nimesh Kampani

Mr. Nimesh Kampani is a Chartered Accountant with vast experience in the field of investments. He is Managing Director of J. M. Financial & Investment Consultancy Services Pvt. Ltd., one of the leading Financial Service Companies of the country. He is a well known and respected Merchant Banker and has been responsible for adding new dimensions to the management of Public Issues. He has also pioneered the Marketing of new issues to Non-Residents and thus opened up new vistas for the capital markets. He is on the Board of several reputed companies and a member of the Finance and Banking Subcommittee of Indian Merchant Chambers. He has attended several seminars as faculty and contributed several papers on investment and financial management.

Mr. Arun Agarwal



Mr. Arun Agarwal

Mr. Arun Agarwal has obtained a First Class Masters Degree in Science from Dartmouth College, Hanover, USA, in 1965. From 1966 till 1969 he was serving with the Birla Group of Companies, at Calcutta. In 1970 he joined DCM, Delhi, and thereafter, from 1974 onwards he has served in the capacity of Managing Director with Mas Services Pvt. Ltd. He is a recognised computer expert and a member of several computer societies and other organisations. While studying in USA, he was also associated with the development of BASIC, now an internationally accepted computer language. Under his leadership, MAS Services Pvt. Ltd., has emerged as leading Registrars of Public Issues and he has, till date, handled over 400 issues.

CAPITAL ISSUES - A REGISTRARS'

VIEWS

Mr. Arun Agarwal.

With the boom in the capital market that prevailed in 1985, and with equities touching new heights, just about all Issues received very great support from the investors irrespective of the actual merits of these Issues.

The boom in the capital market experienced in 1985 has waned. The boom was followed by continuous downward reaction, with occasional recovery phases. The number of new Issues failing to collect full subscription from the public has increased sharply. Public Issues which are now able to succeed in the market are only those which are promoted by large established houses or by companies with a proven track record. New promoters' issues succeed when such companies come to the market after the project is ready to start commercial production or the project itself is considered very profitable.

We have summarised some data on the Issues handled by us which gives some very interesting conclusions. The details of data enclosed are as follows:-

1. Collection Centrewise response to all Public Issues handled by us during 1985-87 (Annexure - 1).
2. Townwise response to 3 major Public Issues handled by us during 1987 (Annexure - 2). Issues included are Venlon, Hoganas and Cable Corporation.
3. Countrywise Analysis of Subscription by Non-Resident Indians to Public Issues handled by us during 1986 (Annexure - 3).

On analysing the data, we find that about 64% of the response to Public Issues comes from places where Stock Exchanges are in existence and the total response from 32 major cities having population of more than 7 lacs is about 77%.

It is interesting to note that this 77% response comes from cities which in total have only about 9% of the population of the country i.e., about 6.4 crores out of 76.5 crores.

It is further observed that the Equity cult is more wide spread in Maharashtra and Gujarat compared to other States contributing about 50% of the total response to the Public Issues. Amongst the cities, Bombay is the highest contributor having contributed more than 25% of the total response followed by Ahmedabad and Delhi.

Further, Delhi, which accounts for as much as 15.5% in the Collection Centre Wise Response, accounts for only 7% in the Town Wise Response, implying that nearly 50% applications received in Delhi Banks come from upcountry towns.

Amongst the States from where there is very negligible response or no response at all are Bihar, Mizoram, Manipur, Meghalaya, Nagaland, Tripura, Himachal Pradesh, Orissa and Jammu & Kashmir.

In Annexure 3, we have given the country-wise Analysis of the response to the various Issues handled by us during the last two years. This shows that the response from the Gulf Countries was to the extent of 61% and among the Gulf Countries, Dubai and Kuwait were the largest contributors to the capital market of India, followed by Oman and Abu Dhabi. South East Asia, Europe and U.S.A. have also contributed to the extent of about 7% each.

I would like to mention some suggestions for improving service to investors which in a small way, may also help in reviving the investment sentiments.

1. PROTECTION TO INVESTORS

AND REMOVAL OF DELAY-REFUND

As you are aware, presently the Refund of Application Money is sent to the applicants through post, hereby sometimes resulting in loss in transit and delay, etc.

I would like to suggest that in the Application Form the applicants should be asked to mention the name and address of their bankers and their account number. The company should make the Refund Order in the name of the Bank, mentioning the Account Number of the Applicant and name of the Applicant. There after the Refund Order should be sent directly to the bankers of the Applicant for credit in his account. It will help in speedy disposal of the Refund Order. Application Form can be suitably amended for the purpose. Subsequently the Dividend/Interest Warrants can be handled in the same way.

This is already being done for Non Residents where their Refund is being sent to their NRE Accounts in India under intimation to them.

2. PAYMENT OF REFUND ORDERS INTEREST WARRANTS/DIVIDEND

WARRANTS AT PAR ALL OVER THE COUNTRY

From the townwise statement attached hereto, we have drawn a very interesting conclusion that it is only about 9% of the investing Public who have to pay the collection charges to their Bankers for encashment of Refund Orders or Dividend/Interest Warrants. The balance 91% amount goes to such places where the companies generally do appoint a branch of their Bankers for making the payment at par.

I do think that non-payment of Refund Orders/Dividend Warrants or Interest Warrants at par is one of the reasons for lower investments from these areas. An applicant residing in a moffusil area, besides paying postage, has to pay the collection charges to his bankers resulting in a substantial loss to him without any fruitful gain in case he does not get the allotment. After he gets allotment he continues to pay charges for every Dividend/Interest Warrant.

Therefore, I would suggest that it should be made obligatory for every company to ensure payment of Refund Orders, Dividend Warrants, Interest Warrants at par at all locations. In case Bank Branches are not situated at the place of residence of an applicant shareholder, he should be reimbursed his collection charges.

I may mention that some forward looking companies, like Hindustan Lever/Hoechst have already made a very good beginning by promising to reimburse the collection charges to people of areas where no Bank branch was appointed to make the payment of instruments at par.

3. DELISTING

A lot of hue and cry is made that maximum steps should be taken to safeguard the interest of the investors. But are we doing so? Recently the Governing Board of

the Bombay Stock Exchange has delisted 98 companies from the official list. This may be due to non-payment of listing fees. Does this not amount to ransacking lacs of shareholders of these companies? Most of these companies are also listed at some other Stock Exchange i.e. the Regional Stock Exchange. However, the action of the Bombay Stock Exchange for delisting these companies is not at all in the interest of the Shareholders, since we have seen nearly one out of every 4 shareholders is from Bombay. Leaving aside those companies who are listed at some other Stock Exchange, the shares of delisted companies have become totally non saleable. Some of these companies belong to renowned groups of the country and who have used the names of well-known personalities while raising money in their companies, otherwise these investors would have put their hard earned money on a fixed rate of interest, but today they have been left with a worthless piece of paper because of delisting.

In my opinion, instead of delisting a company, the Stock Exchange should take effective steps to check that a situation like delisting of a company does not arise e.g. by levying penalties or prosecution of Management in whatsoever situation it may be because at the time of Public Issue they had given a commitment that the Shares of the Company would be listed.

In addition to the above, in my view it should be made compulsory for every company that besides being listed in its local Stock Exchange i.e. in proximity to its Registered Office, it should compulsorily enlist its shares where the maximum number of shareholders is residing. This will certainly broad-base the shareholders and give a boost to the Capital Market. Data reveals that the existence of a Stock Exchange has increased the number of investors in the proximity of the area of the Stock Exchange.

4. APPOINTMENT OF SCREENING PANEL TO SCREEN

NON-APPRAISED PUBLIC ISSUES

Recently it has been proposed that the Stock Exchange should appoint a Screening Panel to screen all Public Issues which have not been appraised by institutions. As mentioned, the scope of the screening could extend to,

inter alia, checking the bona fides of the promoters, the possibility and viability of the project and the attractiveness of the Issue to the investors. I fully endorse the idea that all the issues being considered for listing should be appraised so that no one can take the gullible investor for a ride.

5. TRANSFER OF SHARES AND CONCEPT OF ODD LOTS

The Transfer Deed for transfer of shares is valid for 2 months from the date of stamping by the Prescribed Authority or the closure of the Register of Members of the Listed Company from that date whichever is later. The substantial time involved in getting the shares transferred, from time of giving instructions by the seller to the Stock Broker till these are actually transferred in the name of the Transferee, is well known. This time lag, besides sometimes making the Transfer Deed invalid, also defeats the purpose for which the Transferee might have purchased the shares.

The Investors in the Stock Market are also facing the problem of Odd Lot Shares besides that of Transfer of Shares. Exchange Authorities have recently recommended the names of 16 persons who can act as Odd Lot Agents, who will consolidate the shares into marketable lots in their name and after deduction their commission, will send the sale proceeds to the shareholders. It is claimed that this is one of the steps among many others to safeguard the interest of the investing public.

The financial institutions, in an effort to remove the difficulties and delay experienced in transfer of shares and claiming of Dividend, Bonus and Rights shares have set up a Stock Holding Corporation recently. The Stock Holding Corporation of India Limited has been set up by the 7 Financial Institutions to process their post trading activities in Shares, Debentures and Bonds.

SHCIL has Paid up Capital of Rs.7crores contributed by DBI, ICICI, GIC, LIC, UTI, IRBI and IFCI. The Corporation will complete the post trading activities of buying and selling the shares of financial institutions, and remove a lot of paper work and time involved in getting the instrument registered in their name. The SHCIL will maintain in its possession all the instruments

purchased by all these institutions and the buying and selling of securities will be conveyed to it merely for adjustment in its books. This will eliminate the need for physical delivery of the instruments and consequently save time. I would suggest that the SHCIL should also provide these services to individual shareholders. This will help to smoothen the working of the stock market as the difficulties experienced by the investor in getting the shares transferred in his name would be eliminated and the activity of buying and selling Odd Lot Shares would be simplified.

6. TAXABILITY OF DIVIDEND IN CASE OF NON RESIDENTS

The Government in the budget for 1982-83 and 1983-84 and thereafter has liberalised various facilities for investments by Non Residents of Indian Nationality/Origin. The various incentives include portfolio investment in Shares/Debentures subject to a ceiling of 1 per cent of the Paid Up Capital of the Company in case of Shares, and 1 per cent of each series of Convertible Debentures, with an overall ceiling of 5 per cent. In case of new Issues of Indian Companies investment upto 74 per cent in certain priority industries and 40 per cent in others (with full benefits of repatriation of capital and income) is allowed. Fiscal concessions have also been granted, in case Non Resident Indians do not have any other income, by way of flat rate of taxation at the rate of 20 per cent, and exemptions from Wealth Tax and Gift Tax.

The Union Government has waived in May 1983 the requirement of getting Reserve Bank of India's permission in case of transfer from Non-Resident Indian to Indians whether resident in India or outside India, provided the shares are purchased by the transferee through a member of a Stock Exchange and the proceeds of such shares sold by the transferor are credited to his Ordinary Non-Resident Account with Non-Repatriation rights.

In my opinion, in case of those Public Issues where the Reserve Bank of India permits the Public Issue to Non-Resident Indians on Repatriation Basis, some incentives can be offered whereby they are induced to let their Dividend/Interest Income remain in India. A scheme can be framed whereby

Non-Resident Indians can be permitted to opt their Dividend/Interest income either on Repatriation Basis or on Non Repatriation Basis. In case non Resident Indian(s) opt for their income on Repatration Basis, the Dividend/Interest can be taxed as per the existing laws of the country but in the case of those Non-Resident Indians who opt for their Dividend/Interest income on Non-Repatriation Basis, their Dividend/Interest income should be made fully exempt from the provisions of the Income Tax Act and should be credited to their Ordinary Non-Resident Account as mentioned earlier. It will certainly help in restricting the outflow of Dividend Income to Non-Resident Indians to some extent.

According to the Reserve Bank of India's report on currency and finance the number of proposals approved by the Reserve Bank of India with the facilities for full repatriation rights to Non-Resident Indians went up to Rs. 423 crores in 1986-87. Even assuming that only 50% of the Non Resident Indians will opt for the Non Repatriation Scheme and the Companies declare 15% average dividend, the Annual Foreign Exchange savings can increase by about Rs. 30 crores.

7. AMENDMENT OF CRITERIA REGARDING ELIGIBILITY OF ISSUE

FOR THE PURPOSE OF SECTION 80 CC OF THE INCOME TAX

ACT, 1961.

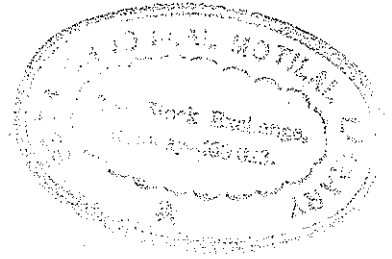
As per the provisions of Section 80 CC, an Eligible Issue of Capital for the purpose of getting deduction from the income is that the Issue should be an Issue of Capital made by the Company for the first time.

In other words, it means that an Issue of Capital made by the company would be considered for the purpose of exemption only once in the life of a company. If a company goes in for diversification or expansion after successful implementation of the project, the Public Issue brought by it thereafter will

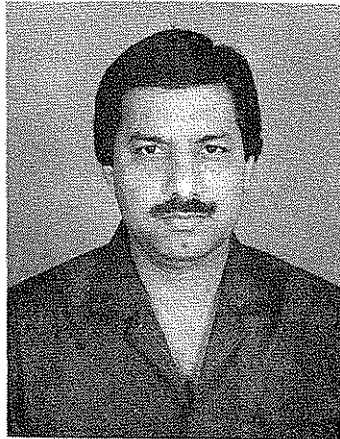
not be considered an eligible issue u/s 80 CC of the Income Tax Act. This anomalous situation will discourage the investor from investing in the Public Issue of a company which is coming to the market 2nd or 3rd time or thereafter, for raising the resources for expansion or diversification. This will defeat the purpose for which Section 80 CC was enacted i.e. helping the growth of industry in the country. The provisions of the section should be suitably amended to make it more inducive to the capital market.

Section 80 CC further provides that Public Issue by a Company which has been converted into a Public Limited Company from Private Limited Company cannot be termed as an Eligible Issue of Capital if it has ever declared Dividend. Take a hypothetical situation where a profitable Private Limited Company which had declared Dividend was working on a small scale basis, and wishes to diversify or expand. It gets itself converted into a Public Limited Company after complying with all legal formalities. It enters into the market for raising resources. The Public Issue brought by this Company will not be considered as an Eligible Issue as it has previously declared Dividend. It implies that when a Private Limited Company who had not declared dividend and is not being managed well comes to the market, its issue will be considered as an Eligible Issue, thereby encouraging layman investors to invest in a company which is not being managed well whereas, on the other hand, the layman investors would be discouraged from investing in a company which is being managed well. This anomaly should be avoided forthwith and all those Public Issues which raise resources for Construction/ Installation of Plant and Machinery etc. should be considered as Eligible Issues of Capital.

In my opinion the above, on one hand, will boost the Capital Market and, on the other, will also help in industrialisation.



Mr. Bhagirat B. Merchant.



Mr. Bhagirat B. Merchant.

He became a Chartered Accountant in 1971 and, after two years of brief practice, joined a prominent, and the first private sector Merchant Banking Company, in 1973, where he worked for ten years. One of the first to tap Non-Resident resources immediately after the Government of India announced for the first time guidelines for the Investments of NRIs on repatriation basis in September 1975. He started his own Merchant Banking Company in June 1983 and also became a member of the Stock Exchange, Bombay in February 1985. He is also on the board of several companies.

Mobilisation of resources

from

Non-Resident Indians.

By

Mr. Bhagirat B. Merchant

Background :-

The presence of overseas Indians in the Capital Markets of India started from January 1976, when 2 companies, namely Appollo Tyres Ltd. and Carbon Corporation Ltd., almost simultaneously attracted subscriptions towards their initial equity issues. After that, very few companies really took advantage of the government's policy to attract NRI funds on repatriation basis till 1980 when TELCO's Convertible Debenture Issue and GNFCs equity issue in 1981, truly speaking heralded the era of NRI presence in the Indian

capital Markets. In 1982 the RBI further liberalised the guidelines for attracting NRI funds towards equity and debenture issues of Indian companies, and also the portfolio scheme for the direct investments in Stock Markets was introduced with much fanfare. From 1983 onwards till 1986, NRI's invested in almost every public issue made by a host of Indian Companies, and it started declining from 1987 onwards for the reasons best known to all of us.

Understanding the meaning and definition of the term Non Residents:-

NRI's are explained and defined differently under the applicable acts, Foreign Exchange Regulation Act, 1973 (FERA) and the Income Tax Act, 1961. The import of the definition under the 2 acts is different and a person may be an NRI under the Income Tax Act but he is not an NRI as per FERA. (e.g., Student studying abroad). Under FERA a NRI is defined as (a) an Indian citizen staying abroad for employment or carrying on business or profession abroad, which requires an indefinite period of stay outside India of such person, (b) the Government employees working abroad on deputation for the Government or agencies like World Bank, International Monetary Fund, World Health Organisation and Economic and Social Commission for Asia and Pacific. This also includes the employees of the State Governments and Public Sector undertakings who are working abroad on deputation or in foreign branches.

A person under FERA is defined as a person of Indian origin if a) at any time if he or she held an Indian Passport, or b) his parents or grandparents were Indians and staying in undivided India. Whereas Non-Resident as defined in Section 6 of Income tax Act is based on a sole consideration of his/her total periods of stay outside the country.

Avenues of Investments:-

Broadly, the following avenues of investment are presently available to INRIs:-

- a) Bank Deposits:- Non Resident (External) Rupee Account (NRE), Foreign Currency Non Resident A/c (FCNR) and Non-Resident (Ordinary) Account (NRO);
- b) Investment with or without repatriation rights in proprietary/partnership firms, and in shares of Companies through Stock Exchanges either as direct investment (new issues of shares and debentures) or portfolio investment. (market purchase);
- c) Units of UTI - 1964 Scheme, Reinvestment Plan 1966, Children's Gift Plan, Capital Gains Unit Scheme 1983, and India Fund.
- d) National Plan/Savings Certificate and Time Deposits - 6 years National Savings Certificate VI and VII issues 7 year National Savings Certificates - II, III, IV and V issues Post Office Savings Account, 10 years Cumulative Time Deposit Account, 15 years Public Provident Fund Account, Post Office Time Deposit and Recurring Deposit Accounts (5 years), 10 years Social Security Certificate, and 4 year National Deposit Schemes (I and II series).

The guidelines issued by Reserve Bank of India, as amended from time to time, and presently in force is given in detail hereunder:-

Investment facilities available to
non-residents of Indian nationality
origin and overseas corporate bodies
owned directly or indirectly but
ultimately to the extent of at least 60%
by such non-residents.

The various investment facilities available to non-residents of Indian nationality/origin (NRIs) were liberalised in terms of the Union Finance Minister's Budget Speech for the year 1982-83 and the same have also been extended to overseas corporate bodies (OCB's) owned directly or indirectly but ultimately to the extent of at least 60% by such non-resident individuals. Certain further schemes have also been formulated by the Government of India consequent on

the announcement of the Budget proposals for the year 1983-84. These facilities and the connected procedures were reviewed by a committee constituted by the Governor of Reserve Bank of India with the concurrence of the Government of India under the Chairmanship of Shri T. N. A. Iyer, Executive Director of Reserve Bank of India in March 1985. Most of the recommendations made by the committee have since been implemented. This note gives a brief account of the various facilities presently available to NRIs and OCBs.

(I) Investment on non-repatriation basis

NRIs can invest upto 100% in any partnership /proprietorship firms or limited companies (except those dealing in real estate business and agricultural activities). They can also make portfolio investment through stock exchange s in shares debentures of Indian companies subject to the condition that the total non-resident Indian investment (both with and without repatriation benefits) in equity shares /convertible debentures in a company does not exceed 5% of the total paid-up equity capital/ total paid-up value of each series of convertible debentures. They can also place funds with firms and companies as deposits subject to the prevailing rules and within the limit prescribed for acceptance of such deposits by companies. Similar investment facilities are also available to OCBs except that these bodies are not permitted to invest in partnership/ proprietary firms.

(II) Investment on repatriation basis

(A) Portfolio investment in share/debentures

NRIs and OCBs are permitted to make portfolio investment in equity shares/ convertible debentures quoted on stock exchanges with full benefits of repatriation of capital invested and income earned thereon provided the investment of each non-resident investor/overseas corporate body in any one Indian company does not exceed 1% of the paid-up equity capital of the company in case of shares and 1% of the paid-up equity capital of the company in case of shares and 1% of the total issue of each series in case of convertible debentures over and above the 1% of equity capital which such persons can purchase as stated above and provided further that the total non-resident Indian investment (both

with and without repatriation benefits) in equity shares/convertible debentures in a company does not exceed 5% of the total paid up equity/ capital paid-up value of each series of convertible debentures. They can also purchase non-convertible debentures of any Indian company without any monetary limit on the investment. For this purpose, it is necessary that shares / debentures are purchased through stock exchanges at the price ruling on the floor of Stock Exchanges and the shares so acquired will have to be retained by the investor for a minimum period of one year from the date of registration.

(B) Procedural Formalities

(a) Portfolio Investment

Under the simplified procedure, Reserve Bank now grants permission to designated banks in India for purchasing shares/ debentures through stock exchanges on behalf of NRIs/OCBs so that the investors are not required to approach the Reserve Bank at the time of each purchase. This permission is valid for five years and can be renewed thereafter, by sending a simple letter. While granting such permission, the Reserve Bank also grants permission to the designated bank to export the shares debentures so purchased to the country of residence of the non-resident investor if so desired by him and also for remitting the dividend as and when declared. Where investment is to be made with repatriation rights, application on form RPI/RPC may be submitted to Reserve Bank's Central Office at Bombay through the designated bank of the non-resident investor. In case of investment on non-repatriation basis, applications are required to be made on forms NRI/NRC in the manner indicated above.

(b) Direct Investment

(i) Indian Companies

An Indian company proposing to issue shares/ debentures to NRIs/OCBs is required to make an application on form ISD to Reserve Bank for necessary permission under section 19(1)(d) of the Foreign Exchange Regulation Act, 1973

giving details of such investors. While granting permission to the applicant company to issue shares debentures to non residents, the Bank indicated in its letter of approval that this permission may also be treated as the Bank's permission under Section 29(1)(b) of the Act to the non-resident investors for purchasing the shares. It is not, therefore, necessary for the non-resident investors to seek separately, the Bank's permission to purchase shares/ debentures in such cases. Reserve Bank has also issued a notification in November 1986 under Sections 19 (1)(d) and 19(a)(b) of the Foreign Exchange Regulation Act, 1973 granting general permission to NRIs to subscribe to the Memorandum and Articles of Association and take-up shares of the company for the purpose of its incorporation provided, inter alia, that the company has obtained letter of intent/ industrial licence /certificate of registration from Central /State Government or any other Government authority and the total face value of shares to be so taken-up by NRIs does not exceed Rs.10,000/-. The Reserve Bank has also delegated powers to banks to allow refunds of subscription money or excess portion thereof either by remittance to the non-resident applicant or by credit to his Non-Resident (External) FCNR Account, or Ordinary Non-resident account as the case may be without reference to the Bank. The Bank also grants on request, permission to the Indian companies to open foreign currency accounts thus avoiding exchange rate fluctuation risk to NRIs. While granting its final approval for issue of fully-paid shares debentures, the Reserve Bank also grants permission to the investee company to export such fully-paid shares/ debentures to the country of residence of the non-resident shareholder, if so desired by him. Where shares are to be issued on non-repatriation basis, application on form ISD for permission to issue shares debentures with repatriation rights under 40%/74% Schemes, are required to be submitted to Central Office of Reserve Bank at Bombay.

(ii) Proprietary/Partnership firms:

In case of investment in partnership/proprietary firms, applications may be submitted in form FIN together with non-repatriation undertaking duly signed by the investors and a copy of draft partnership deed, to the office of Reserve Bank under whose jurisdiction the firm would function.

(c) Investment in Term Deposits:

Applications for acceptance of deposits either with or without repatriation rights may be made by Indian companies/ firms by simple letter through a designated bank giving the relevant details of the deposit scheme, to the regional office of Reserve Bank under whose jurisdiction the company/ firm functions. In such cases, Reserve Bank grants general permission to the designated bank for a period of one year to accept deposits on behalf of the company/ firm concerned subject to certain conditions.

(d) Sale of Shares/Debentures

(i) Without repatriation benefits.

As a measure of further relaxation, central government has issued a Notification in May 1983 under Section 19(6) of FERA 1973 exempting from the operations of the provisions of Section 19(5) *ibid*, transfer of shares of a company registered in India made by a non-resident of Indian nationality/ origin in favour of a person who is a citizen of India or a person of Indian origin whether resident in India or outside India provided that the shares are purchased by the transferee through a stock exchange in India and the sale proceeds of the shares are credited to the transferor's ordinary non-resident account with a bank authorised to deal in foreign exchange in India. By issue of another Notification in June 1986 the above exemption has since been extended to those transactions where the transfer is made in favour of a company or other body corporate in which non-resident interest does not exceed 40%. Consequently, it is not necessary now for such non-resident Indians to obtain Reserve Bank's permission for sale of shares of Indian companies through stock exchanges on non-repatriation basis.

(ii) With repatriation benefits

For permission for sale of shares/ debentures on stock exchanges with intention to repatriate the sale proceeds outside India or credit thereof to the investor's Non-Resident External/ FCNR Account with a bank in India non

Resident Indians/ Overseas Corporate Bodies may make applications into Reserve Bank's Central Office at Bombay through any Bank authorised to deal in foreign exchange in India, by a simple letter. Permission granted in such cases is made valid for a period of four years so that the non-resident seller can arrange with his bank to sell his holdings at a time most suitable to him and to immediately remit to him abroad /credit his NRE account, the sale proceeds of the shares debentures to the extent of the cost of the original investment or the actual sale proceeds, whichever is less, without prior clearance of the Income-tax authorities. The balance excess amount, if any, representing capital gains could be remitted abroad /credited to the NRE accounts after the tax liability is settled. No such tax clearance is, however, necessary in case of long term capital gains arising out of sale of shares of an Indian company or debentures of a public limited company. In such cases the bank can straight away deduct long term capital gains tax at rate of twenty percent and allow the balance to be remitted abroad credited to NRE accounts. (Also see para 4 below).

Where the sale of shares is to be made by private arrangement on repatriation basis, the non-resident seller is required to make application on form TS1 to Reserve Bank's Central Office at Bombay. Where the shares are held by the non-resident seller on non-repatriation basis with Reserve Bank's permission and are to be transferred by private arrangement, application on form TS1 should be made to the concerned Regional Office of the Reserve Bank. In both the cases, permission is required to be obtained for each transaction.

As regard sale of shares with repatriation rights purchased earlier under the Portfolio Investment Scheme, Central Government has issued a Notification in June 1986 under Section 19(6) of FERA 1973 exempting from the operations of the provisions of section 19(5) *ibid*, transfer of shares in cases where (i) shares had been purchased under the Portfolio Investment Scheme (ii) shares are held for a period of not less than one year prior to transfer (iii) shares are sold in stock market through the same designated bank through whom they were purchased and (iv) the sale proceeds are paid to the designated bank. Consequently, it is not necessary now for NRIs to obtain Reserve Bank's permission for sale of shares effected in the above manner.

(e) Stipulation of minimum period of holding

Since the Portfolio investment scheme referred to in paragraph 1 (II)(a) above is intended to encourage only bonafide non-resident investments through stock exchange, the facility of repatriation of sale proceeds of shares which the purchaser may like to sell subsequently, will be made available only if the investment is retained by the non-resident at least for a period of one year from the date of registration of the shares in his name or in the name of the designated bank or the latter's nominee. There are, however, no such restrictions on sale of shares acquired out of new issues of Indian companies under Direct Investment Schemes.

(C) Investment in new issues of Indian Companies under 40% Scheme.

NRIs and OCBs can make investment in new issues of equity shares / convertible debentures of any new or existing company (other than FERA company) engaged in the following types of activities through a public issue with prospectus upto 40% of the new capital issue of the company with full repatriation rights :

- i) Industrial Manufacturing activity;
- ii) Hospital;
- iii) Hotel with 3, 4 or 5 star rating;
- iv) Diagnostic Centres;
- v) Shipping;
- vi) Computer software; and
- vii) Oil exploration services.

They can also invest with full repatriation rights in the capital raised by private limited and public limited companies (engaged as above) other than through the issue of prospectus upto 40% of the issued capital of the company (subject to a quantitative ceiling of Rs. 40 lakhs in case of public limited companies). Investment in non-convertible debenture issues of Indian companies can, however, be made without any limit.

(D) Investment under 74% Scheme

The Government of India, Ministry of Industry operates a Scheme for encouraging non-resident Indian and over seas corporate bodies to invest in priority industries in India with repatriation benefits. Under the scheme, equity investment upto 74% (without any minimum limit) will be allowed for starting any Industry listed in Appendix-I to the Ministry of Industry's press note dated 2nd February 1973 as amended from time to time. Investments are also allowed in any other industry provided the investor undertakes to export 60% of the out put or, in the case of industries reserved for the small sector, 75% of the output. The investment under this scheme is also permitted in case of a hospital project, (including diagnostic centres) as also a Hotel project with 3, 4 and 5 star category. This facility is available for only new investments including expansion and diversification of existing industrial undertakings. The scheme is also available for investment in partnership firms engaged in the above types of activities.

(E) Investment in Sick Industrial Units:

Under a new scheme announced by the Government of India vide Press Note dated 6th May 1986 issued by the Ministry of Finance, NRIs/OCBs will be permitted to participate in the revival of sick industrial units by making bulk investment either by way of purchase of equity shares from the existing shareholders or in the form of subscription to new equity issues of such Indian companies on the basis indicated below :-

- i) Such bulk investments can be made by NRIs/OCBs on private placements basis upto 100% of the equity capital of the sick company concerned with full benefits of repatriation of the capital invested and income earned thereon.
- ii) Funds for investment should be received by remittance from from abroad or from the investors Non-resident (external)/ FCNR Account maintained with a bank in India.
- iii) Repatriation of capital brought into India for the revival of

the sick company will be permitted after a minimum period of five years on merits of individual cases after taking into account the future payment liabilities of the investee Company.

- iv) For the purpose of investment, the company will be considered sick only if (a) a public financial institutions/banks providing credit facilities to the company have classified it as a sick unit on the basis of losses made consecutively for at least the previous three years and the market price of the shares has been below par for atleast two years;
- v) Issue/transfer of equity shares to NRIs/OCBs is approved by the existing shareholders of the company through a Special resolution.

(F) Deposits with Public Limited Companies:

NRIs and OCBs can place funds with public limited companies (including Government undertakings with limited liability) in India for a period of three years with full repatriation benefits provided the deposits are made in conformity with the prevailing rules and within the limits prescribed for acceptance of deposits by such companies.

- (III) Release of exchange for canvassing advertisements abroad and payment of compensation to overseas agents

In order to promote direct investment in new issues of shares and debentures by non-resident Indian and overseas corporate bodies, Reserve Bank releases on application, Foreign Exchange to a reasonable extent, for visits abroad for canvassing as also for advertisements/ expenses abroad. Indian companies can also appoint with the prior approval of Reserve Bank, agents abroad for canvassing and pay compensation upto a reasonable extent for securing such investments on

the basis of the quantum of investment actually made with the help of the agent.

3. Special NRe Cheques

For the purpose of easy identification and proper processing of cheques drawn on INon-resident (External) Accounts and with a view to reduce the delay in getting FERA clearance by Indian Companies for issue of shares to NRIs, it has been decided that a separate series of cheques with prefix NRE should be issued to all Non resident (External) account holders by all the branches of the authorised dealers in India maintaining such accounts. With the introduction of special NRE cheques from 1st April 1987, it will be possible for the banker to the issue/collecting banks to issue a consolidated bank certificate when subscription for shares/debentures is paid by NRIs by means of such special NRE cheques without calling for any certificate from the paying bank relating to origin of funds.

4. Tax benefits

The salient features of the special provisions for NRIs are as under:-

(i) The income derived by non-resident Indian from any foreign exchange asset is called "Investment income". For this purpose, "foreign exchange asset" means any specified asset acquired or purchased with, or subscribed to in, convertible foreign exchange. The assets so specified under section 115-C are :

- (1) shares in an Indian company;
- (2) debentures issued by a public limited company;
- (3) deposits with a public limited Indian company;
- (4) securities of the Central Government; and
- (5) such other assets as may be notified by the central Govt..

(ii) In computing the "investment income" of a non-resident Indian, no deduction in respect of any expenditure or allowance or deductions under Chapter VIA will be allowed under any provision of the Income tax Act. However, where the non-resident Indian elects to furnish return of income to the Income-tax Officer for any assessment year the deductions permissible under the provisions of Income-tax

Act will be allowed for that year.

(iii) Where the total income of a non-resident Indian consists only of "investment income" and/or income by way of "long term capital gains" arising from the transfer of any foreign exchange asset, such income shall be charged to tax at a flat rate of 20% by way of income tax.

(iv) The income from foreign exchange assets (called investment income) and long term capital gains arising on transfer of any such asset will constitute separate block of income and charged to income tax at a flat rate of 20% by way of income-tax. If the non-resident Indian has any other income in India, such other income will constitute as an altogether separate block of income and charged to tax as if such other income had been the total income the aggregate of the income tax so calculated in respect of the said two blocks of income will be the tax payable for the relevant assessment year [Section 115-E(2)].

(v) The long term capital gains arising from the transfer of any foreign exchange asset will be exempt from tax to the extent the net proceeds realised on transfer are re-invested or re-deposited within six months after the date of such transfer in any specified asset (as mentioned in para (i) above) or in a Non-resident (External) account in any bank in India or in any savings certificates notified by the central Government under clause (4B) of section 10 (hereafter referred to as the new asset). However, where the new asset is transferred or converted (otherwise than by transfer) into money within a period of three years of its acquisition, the capital gains arising from the transfer of the original asset which has been exempted from tax shall be deemed to be the long-term capital gains of the previous year in which the new asset is transferred or converted into money (Section 115-F).

(vi) A non-resident Indian has the option to claim that in respect to any particular assessment year the special provisions relating to taxation of "investment income" and "long-term capital gains" under which the tax on such income is to be charged at a flat rate should not apply to him. Such options can be exercised by furnishing a declaration in writing to that effect along with his return of income for that assessment year. In cases where such option is exercised in respect of any assessment year, the whole of the total income of that assessment

year will be charged to tax under the general provisions of the Income-tax Act (Section 115-I).

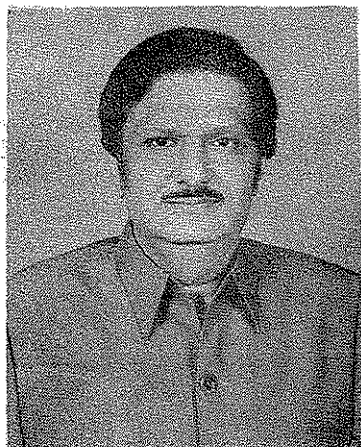
(vii) A non-resident Indian who becomes a resident in any subsequent year has the option to claim that the special provisions of this new Chapter shall continue to apply to him in relation to income derived from foreign exchange asset (other than shares in Indian companies) for that assessment year and for every subsequent year until the transfer or conversion of such assets into money. Such option can be exercised by furnishing a declaration in writing to that effect along with his return of income for that assessment year (section 115-H).

(viii) A non resident Indian having only investment income or income by way of long-term capital gains arising from the transfer of any foreign exchange asset or both need not file the return of his income under section 139(1) if the tax deductible from such income has been correctly deducted at source. However, it is permissible for him to opt under section 115-I of the Income-tax Act to submit the return of income and claim the refund due to him, if any.

(5) The Reserve Bank has set up a special 'Non-resident Indian Investment Cell' at its Central Office in Bombay to deal with proposals and enquiries relating to direct investment in India on repatriation basis and portfolio investment both on repatriation as well as on non-repatriation basis by Non-Resident Indians and Overseas Corporate Bodies.

Apart from handling individual proposals expeditiously and systematically this cell keeps under continuous review, the pace of implementation of various policies and procedural reforms designed to encourage larger inflow of Non-Resident Indian Funds under the various schemes. The cell also serves as a focal point for contact with Non-Resident Indians as well as their representatives and bankers in India. All proposals and other references relating to investments by Non-Residents Indian/Overseas Corporate Bodies on non-repatriation basis excepting the portfolio investment, however, continue to be dealt with in the regional offices of Reserve Bank.

Mr. Mahendra N. Kampani



Mr. Mahendra N. Kampani

Shri. Mahendra N. Kampani, the present President of the Bombay Stock Exchange, graduated in Commerce from Bombay University in 1959. He is also partner of Jamnadas Morarjee and Co., leading Share and Stock Brokers on Bombay Stock Exchange. He started portfolio management in 1968 and is today handling portfolios worth of over Rs. 50 Crores. He is also a promoter-director of J. M. Financial and Investment Consultancy Services Pvt. Ltd., and its Vice-Chairman since 1983. He also holds directorships with various companies.

NOTE ON

"THREE-TIER MARKET"

SUBMITTED BY

MR. MAHENDRA N. KAMPANI

PRESIDENT

THE STOCK EXCHANGE BOMBAY.

The Stock Exchanges in India have over 5000 companies listed on them. These companies vary significantly with reference to share capital, scale of operations, turnover, number of shareholders, yet remain officially classified for listing purposes as specified and non-specified. The specified group consists of blue chip companies whose shares are highly traded and whose share prices are sensitive to performance and economic criteria. The specified group of companies on the Bombay Stock Exchange, which is the largest stock exchange in India, contains only 70 companies, the balance being in the non specified group.

In every country's history there comes a time when investors realise the hidden potential of investment in shares of listed companies and commence buying operations simultaneously. This increases the existing demand for shares and pushes share prices to high levels. The primary and the secondary markets, then, become buoyant on account of the widespread indiscriminate buying by investors.

Such heady markets are desired by all countries and by all investors, as in them,

there are numerous buyers for every share and such buyers are willing to pay a good price for the available shares. There is, therefore, no problem of marketability of shares. Also, the sudden increase in share prices induces investors to part with high priced holdings and use the proceeds to public issues of new ventures whose shares promise high returns consequent to the increase in demand for any scrip.

During such times, entrepreneurs, taking advantage of the prevailing situation, float new ventures, push expansion plans and generally satisfy their requirements for venture capital. During such time, some companies, whose schemes are not sound, also get their share capital subscribed to. During such times, the regulatory machinery becomes inadequate, as circumstances change dramatically overnight, and the need for further regulations, in spite of its being felt, cannot be responded to. Besides, the necessity for slowing down the increase in share prices does not manifest itself till a later period in time when prices begin falling.

Such heady markets are generally followed by :-

- (1) Wide falls in the price of shares.
- (2) Lack of liquidity in shares as share prices are too low for disinvestment.
- (3) Low marketability of shares due to lack of demand.
- (4) The realisation of the need for regulation of stock markets and the markets' participants.

In India 1985 was such a year. Subsequently share prices fell and seem to have stabilized now in January 1988. However, the need for regulation of the securities' market will bring about the National Securities' Board, an organisation similar to the Securities & Exchange Commission (SEC) in the U.S.A. The SEC was formed after the Great Depression of the 1930's. Even today, falling prices in world stock markets have identified the need for additional rules and regulations.

Apart from regulation, the need for categorizing the companies listed on the stock exchanges has also manifested itself. This is the normal consequence of high growth in the number of listed companies. The reasons behind this need

are as follows:-

- (1) To enable companies to meet the listing requirements of the stock exchange. Companies, quite often, are not geared or responsive to meeting the present rather simple listing guidelines. The stock exchange's only remedy to noncompliance is the threat of suspension of dealings and/or the delisting of the company which action would not be in the investors interest. As listing guidelines have to be further enhanced, it is necessary that the listed companies have the resources, the ability and the desire to meet such guidelines. This also underlines the need for less stringent guidelines for smaller companies who shall, otherwise, be denied the opportunity to participate in and obtain their requirement of capital from the primary capital market due to their inability to meet the prescribed common listing guidelines.
- (2) To increase liquidity by prescribed norms and methods depending upon the categorization of companies. The smaller companies and new entrants shall have to provide marketing support through their appointed sponsor brokers and marketmakers.
- (3) To permit investors to gauge the stature of a company by its categorization. Investors shall then be able to gauge whether a company's share is immediately marketable or not. Investors will also be able to gauge the safety of the investment being made by them i.e. blue chip to high returns/high risk.
- (4) To provide a path to companies to grow into the higher category in steps thereby ensuring that companies seek the listing level to which they belong as well as be committed to the listing guidelines of the level. This will give companies the impetus they desire to move into the higher market. Further, the stock exchange would also recommend the movement of companies to the higher market in which their shares should be traded based on an annual view of their performance/eligibility.
- (5) To ensure that select smaller greenfield companies can avail of the facility of raising capital from the capital market.

(6) To permit control of each category according to its needs.

Out of the sixteen recognized stock exchanges in India today, the Bombay Stock Exchange is the largest having 1911 listed companies and 3172 listed stock issues as at 31st December 1986. The Capital listed in Bombay on 31st December 1986 accounted for 66% of the overall capital listed on all the stock exchanges, whereas its share of market capitalization amounted to 78% on the same date. The Bombay Stock Exchange can be said to be the best equipped stock exchange in India today and therefore it is proposed that the 'Three-Tier Market' be first introduced in Bombay.

It is proposed that initially the companies be divided into 3 categories and that the markets in which these companies are to be traded in be also treated as separate though these are but segments of the main stock market. The category into which a company would fall should be identified by the name of the market i.e. to say 'The Big Board Companies', 'The 2nd Market Companies' and 'The 3rd Market Companies'.

The premier market in which the blue chip and large companies would be categorized would be 'The Big Board'. Such 'Big Board Companies' would be the biggest and the best and the other two markets would contain the lesser companies. Further such categorization should apply on an all-India basis. Different eligibility norms would have to be defined for the three markets and some suggestions are as follows :-

EQUITY SHARE CAPITAL:

The issued and subscribed Equity Share Capital in respect of three types of companies could be as follows:-

Big Board	:	Above Rs. 4 crores.
2nd Market	:	Over Rs. 1.5 crores but below Rs. 4 crores.
3rd Market	:	Over Rs. 25 lakhs but less than Rs.1.5 crores.

Based upon statistical sampling, the approximate number of companies on the Bombay Stock Exchange falling into these categories would be 400, 500 and 1000 respectively.

PUBLIC SHAREHOLDING:

The shares which are held by the public (i.e. other than by the promoters and their immediate family) at the time of application for listing and thereafter must be maintained as follows:-

- Big Board :** At least 40% of the total Equity Share Capital when 60% of the equity is offered to the public. In case of companies who can avail of specific exceptions on the quantum of equity to be issued to the public then 2/3rd of the equity offered to the public for subscription. The term 'Equity offered to the Public' could include private placement upto a specific percentage.
- 2nd Market :** At least 30% of the total Equity Share Capital when 60% of the equity is offered to the public. In case of companies who can avail of specific exceptions on the quantum of equity to be issued to the public then 1/2 of the equity offered to the public for subscription. Again private placement upto a specific percentage could form part of the equity offered to the public.
- 3rd Market :** At least 20% of the total Equity Share Capital offered to the public or privately placed.

Importance is given to Private Placement as the cost of raising small amounts of capital through public issues can be as much as 25% of the capital raised. Private Placement being cheaper will induce companies to get listed in the 3rd Market and ultimately result in their getting an experience into the functioning of stock

exchanges and the regulations to be observed by them on listing.

TRACK RECORD:

To qualify for listing a company should have been in existence for some period and have some trading record. The eligible periods which can be considered are given below:-

- Big Board : A trading period of at least 10 years - 3 years out of the last 5 years working should have been profitable.

- 2nd Market : A Trading period of at least 3 years - 2 years out of the last 3 years working should have been profitable.

- 3rd Market : A Trading period of at least 2 years - last years working should have been profitable.

EXCEPTIONS:

The slotting of companies into the 3 markets would initially require relaxation of eligibility norms particularly in the interests of investors as shares in companies already enjoying full listing status could suffer a loss in value depending on change. Hence is considered that an initial 3 year period should be earmarked as an "Exception Period" to be available to the companies at the discretion of the stock exchange authorities.

In addition to this discretionary power which could cover the first 3 years after the formation of the 3 markets, the stock exchange authorities shall have the authority to relax guidelines for entry where trading performance has been inadequate or has been projected as inadequate (long gestation period) or where the promoters' track record has been exemplary or where any market factor exists which can determine the market in which the company should trade. However, the protection of investors' interest must be the dominant factor behind these exceptions.

OTHER CONDITIONS:

PROSPECTUS:

The issue and filing of a prospectus is a must for the Big Board and 2nd Market companies. The 3rd Market companies could issue an abbreviated statement in lieu of prospectus (norms should be prescribed after consultation with the stock exchange). However, a 3rd Market company can issue a full prospectus, if it desires to. Another advantage of private placement and its low costs is that it satisfies the need for better and personalised presentation of investment criteria for attracting private investors. Also, the possibility of a full prospectus accompanying all private placements (which qualify for listing on the stock exchanges) could be considered as the cost of private placement is low.

FINANCIAL APPRAISAL:

Generally all new companies should have been appraised by financial institutions or screened by the stock exchange screening committee.

SPONSORING BROKER & MARKET MAKER:

A sponsoring broker is a must for 2nd and 3rd market companies and could be prescribed for Big Board companies at the discretion of the Stock Exchange Authorities. Likewise marketmaking could be a function entrusted to the sponsoring broker or given to a specialised market maker. However, for effective marketmaking, it is necessary that certain proportion of the companies' shares should be held by the marketmaker. In initial years of this new activity, the shares could possibly be held in institutions to be made available to marketmakers for their function. Such holding of shares by marketmakers could be as follows:-

Big Board	:	1% of the issued equity share capital.
2nd Market	:	3% of the issued equity share capital.
3rd Market	:	10% of the issued equity share capital.

In marketmaking activities the necessity of some percentage of equity shares being allotted to the marketmaker at the time of private placement or public offer should be considered as this would promote this function.

PUBLICATION OF INFORMATION :

The need for publishing financial results at regular intervals has been acknowledged. The eligibility for the three types of companies could be as follows :-

Big Board : Abbreviated and unaudited results within 2 months' of the quarter ending dates in respect of each quarter and for the final quarter within 3 months of the end of the year.

2nd & 3rd Market: In respect of the first six months within 2 months of its end and of the final six months within 4 months of the end of the year.

In addition, at the end of the year, alongwith the final quarter or six months results should be published the names of all holding and subsidiary companies as well as the names of holders of more than 10% of the issued equity share capital.

DISCLOSURE POLICY:

Before going public, every company should make adequate disclosure of facts which are likely to materially affect its future prospects. All listed companies should be placed under an obligation to report to the stock exchange sensitive information for announcement so that such information precedes movements in share prices rather than after the movements in share prices take place. For such purpose, the stock exchange can consider suspending dealings in a company's shares for a period of 2 to 3 days or even longer, when an important announcement is expected. This will result in curbing speculation on account of inside information which could precede Bonus announcements etc. and protect the interests of

the genuine investor. All listed companies should be encouraged to make the most of this facility which could be offered by the stock exchange and request the stock exchange to suspend dealings for a specified period of time. Hence, it is proposed that definite norms for announcement of sensitive information and suspension of trading prior to announcement should be drawn up for use in specific or relevant circumstances.

The 2nd and 3rd market companies can have lesser obligation to meet such conditions as their share prices need not fluctuate as widely as that of Big Board Companies.

FINES:

Whenever there is a violation of the listing requirements or specific disclosure policies, the National Securities' Board should consider the imposition of fines on the various categories of companies. The range of such fines could be as follows

:-

Big Board	:	From Rs. 1 lakh to Rs. 20 lakhs
2nd Market	:	Rs. 50,000 to rs. 10 lakhs
3rd Market	:	Rs. 10,000 to Rs. 2 lakh

The possibility of being penalised by way of fines would also encourage listed companies to adhere to listing guidelines and disclosure policies.

In conclusion, it can be said that the establishment of "THREE-TIER MARKET" would improve the marketability and liquidity of shares, protect the interests of investors, provide investors with some idea of the company based on its market category, improve the quality of companies' adherence to listing guidelines and disclosure policies, permit small companies to raise capital through private placement and yet enjoy listing facilities, improve by category the control on the functioning of the capital market, and ultimately also result in better mobilization of resources through the capital market.

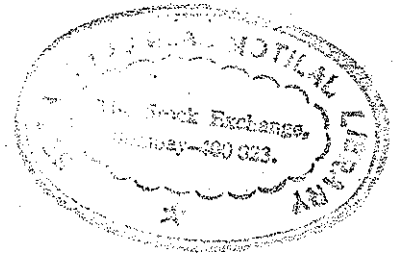
"PRESENT LISTING REQUIREMENTS

OF THE BOMBAY STOCK EXCHANGE

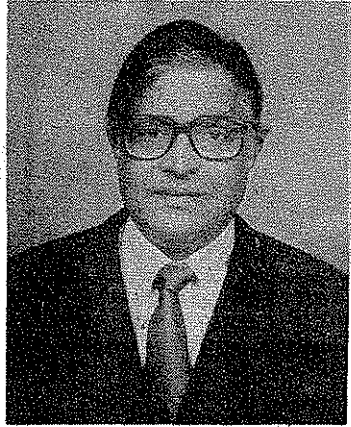
(IN BRIEF)

1. The Memorandum & Articles of Association of the company must provide for free transfer of shares; restriction of shareholder's liability to the extent of the shares' issue price; registration of transfer regardless of whether the transfer/ shareholder owes any money to the company; option or right to shares to be given only after the sanction of the company in general meeting; non-forefeiture of unclaimed dividends prior to the claim becoing timebarred; and denial of rights to dividends and to participation in profits for calls paid in advance on shares.
2. The company must offer for public subscription the prescribed minimum percentage of its issued capital as laid down in the stock exchange rules.
3. The prospectus making the public offer must conform to the standard conditions prescribed by the stock exchange.
4. Allotment of shares to the public in respect of applications received must be fair and equitable and made after consultation with the stock exchange.
5. The company must execute the stock exchange listing agreement. The listing aggrement requires the company to follow procedures & adhere to specific conditions regarding allotments, share certificates, splits, con-

solidations, renewals, transfers of securities, transfer-books, dividends, publications of results, furnishing of information to the stock exchange, shareholding, takeover offers and other associated matters. The listing agreement also specifies the listing fees which have to be paid by the company both initially on listing and annually thereafter.



Mr. Philip Thomas



Mr. Philip Thomas

Mr. Philip Thomas is M.Sc in Economics from the London School of Economics. He was working with the Reserve Bank of India for sixteen years, from 1960 to 1976. The first ten years he was Deputy Director of research and the next six years as Deputy Chief Officer of the Industrial Finance Dept. He joined IDBI as General Manager in 1976 and in 1983 was appointed as Executive Director. Presently he is the Chairman of the Stock Holding Corporation of India Ltd. He has been associated with several committees set up by the RBI and IDBI and has travelled widely to participate in various international conferences.

ROLE
OF
STOCK HOLDING CORPORATION
OF INDIA LTD.

PHILIP THOMAS, CHAIRMAN

Stock Holding Corporation of India Ltd.

I thank you for inviting me to speak at this session on the "Secondary Market" in the Seminar on "Capital Market-Problems and Prospects". I shall confine my remarks to the role which the newly established Stock Holding Corporation of India Ltd. (SHCIL) may be expected to play in the development of the capital market and more particularly the secondary market.

SHCIL which formally commenced business in October 1987 expects to start its operations in another three to four months' time. The Corporation has been set up on the initiative of the all India financial institutions under the leadership of IDBI. Presently the entire share capital of the Corporation amounting to Rs.7 crores is subscribed and taken up by the 7 all India financial institutions. The Corporation's Board is also drawn from senior executives of the institutions. As SHCIL is an all India institution, it will be having its offices at all the principal

centres having stock exchanges.

Objective of SHCIL

The vital role which SHCIL will play in the development of the capital market and especially the secondary market will be obvious from the fact that SHCIL's principal purpose is to eliminate avoidable paper and paper related work and thereby facilitate transactions in shares, debentures and bonds. SHCIL's activities will be mainly related to the offering of improved and efficient post trading services on the stock exchanges. In this respect the Corporation would seek to function on the lines of similar agencies in other countries, say for instance, the Depository Trust Company (DTC) of the USA, which is perhaps the largest agency engaged in similar type of business. DTC came on the scene in the 1960s when the volume of paper work involved in share transactions in the U.S. threatened to bog down the smooth operation of the share trading system in that country.

The enormous volume of paper which DTC has helped to eliminate has been graphically brought out in one of the recent publications of DTC. According to this, DTC's Fast Automated Securities Transfer (FAST) system helped to eliminate as of end 1982, 4.7 million share/security certificates, which, if stacked one on another, would have mounted to a height of 2350 feet, taller than the tallest building in New York, namely World trade Centre (1350 ft.) or the tallest building in Chicago, Sears Tower (1454 ft.). With elimination of paper there is also elimination of enormous amount of paper related work.

Need for improved post trading services

In India even with much less volume of shares and similar securities and trade in these, the inadequacies of the existing post trading services system have imposed not only enormous costs on the participants in the trade but have increasingly been coming in the way of the growth of the capital market. At present, for instance, in the Bombay Stock Exchange there are reported to be on an average every day 15,000 transactions in A scrips and 40,000 in B scrips and at every settlement 25 lakh shares of A scrips and 100 lakh shares of B scrips are delivered. Sellers of shares generally have to wait several weeks upto five weeks or more for getting

their sale proceeds. Buyers have to wait 3 to 6 months to get their registered scrips.

A paperless system on the pattern of DTC could confer several advantages. First quicker processing and faster settlement could increase the liquidity of shares. Second, there would no longer be a constraint of marketable lots and the problem of odd lots could be eliminated. Third, mistakes and bad deliveries would be reduced as a result of elimination of avoidable paper work. Fourth, the periodic spurt in transfer processing which now occurs at the time of book closure would be eliminated and the work load would be more evenly spread throughout the year. Fifth, quicker transfers could make equity investments attractive to wider classes of investors.

The increased liquidity for the investments and easier availability of scrips for trading would help to spread the equity cult. As is well known, at present equity investment in India is largely an urban phenomenon with one city - Bombay - alone accounting for 60-70% of all investments and trading. As a recent study of ownership of shares by category of occupation has shown, nearly 70% of individuals who own shares are professionals and self employed people or salaried persons or persons engaged in household work presumably spouses of the first two categories. **1 With rising agricultural incomes and the growth of economic activity in smaller towns and rural areas, it should be feasible to spread the equity cult to newer classes of investors. A restructuring of the trading and post trading services system can in fact help to bring such newer classes of investors to the market and thus impart new vigour to the growth of the capital market.

Apart from bringing newer classes of investors from semi urban and rural areas, ease of transferability of ownership of shares would attract larger number of genuine investors into the market and help in curbing speculative transactions. At present many genuine investors in scrips are put off from the market because

**1 Ownership pattern of shares and debentures of I D B I

Associated Companies, IDBI, May 1985, p 47.

of the difficulties and long delays in transfer of shares and on the other hand the system attracts large numbers of investors who are interested in speculative profits and not in long term ownership of scrips. Reform of the system of share transfers through the functioning of Stock Holding Corporation could thus give fresh vigour to the capital market while helping to curb speculative trade.

The volume of new capital raised in the market is expected to increase to over Rs.6000 crores per annum from the present level of around Rs.2700 crores (including bonds of public sector companies) and the number of security owners is also expected to increase several times from the present level. Market turnover which has registered large increases over the past four years is expected to increase markedly in future too. For instance, the turnover in the secondary market in Bombay Stock Exchange at Rs.13,596 crore in 1986 was 122% higher than in 1985 (Rs.6134 crore). In 1984 the turnover was Rs.4455 crores as against Rs.2401 crore in 1983. ** 2 In line with trends elsewhere, securitisation of the capital market can be expected to gather momentum in India too. The policies for deregulation of the economy and for reform of the stock exchanges would add further impetus to the securitisation process. Already, as revealed by the data on financing pattern of projects assisted by IDBI, there is a trend towards larger share of project cost being financed through the capital market than from loans and share subscriptions by the institutions. Progressively, the role of the specialised term lending institutions in India will come to be to finance small enterprises and new companies which cannot meet their requirement of finance from the market either because the promoters are relatively new or because the requirement of finance is so large that it cannot be immediately raised in the market.

Need for change in the Present System

In the above context, the setting up of SHCIL should not be viewed merely as the creation of a new agency to do the safe custody and securities servicing

**2. Annual Report, 1986, The Stock Exchange, Bombay Table VII.

function which banks have been doing till now. The new agency should be able to bring in a new way of doing business which should result in marked savings in terms of resources utilised, and the time taken for effecting transactions. It should also be able to claim reliability, accuracy, safety and responsiveness as the hall mark of its service. Otherwise a large part of the potential benefit of setting up a specialised agency of this type would be lost.

Need to eliminate procedural hurdle of share transfer deeds

Viewed in this light, the central problem which SHCIL has to tackle relates to the procedures which are presently followed in regard to transfer of shares. The Committee appointed by the Government of India recently under the Chairmanship of Shri R. N. Bansal, Joint Secretary, Government of India, has made several useful suggestions for clearing the backlog of share transfers. But it is felt that further procedural reforms in this area are long overdue. Central to this would be a fresh look at the system of share transfer certificates. In terms of Section 108 of the Companies Act, 1956, "A company shall not register a transfer of shares in, or debentures of the company, unless a proper instrument of transfer duly stamped or executed by or on behalf of the transferor and by or on behalf of the transferee and specifying the name, address and occupation, if any, of the transferee, has been delivered to the company along with certificate relating to the shares or debentures, or if no certificate relating to the shares or debentures, or if no certificate is in existence along with the letter of allotment of the shares or debentures".

The instrument of transfer or the transfer deed has to be delivered to the company, completed in all other respects, before the closure of the company's register or within two months from the date of its stamping or endorsement, whichever is later.

The rationale for introducing Section 108 was to restrict the period of currency of blank transfers. In the absence of such restriction, there would be a tendency to carry on dealings in shares through blank transfers for prolonged periods and for several rounds of sales and purchases and to save on payment of stamp duty as well as avoid revealing the identity of the true beneficial owner. However, as the system works at present, blank transfers do continue as allowed under the

law and by the time the transfer deed and its attendant securities are delivered to the bank or other agency for completion and lodgement with the companies for effecting transfers, hardly a few days are left, with the result that the bank or other agency concerned is not able to complete the transaction within the time available. Also in several cases companies return the documents for rectification of technical defects before the transfer could be effected. As the formalities cannot often be completed within the time limit set, fresh transfer deeds have to be executed and the process repeated. By then the seller having disposed of his interest in the scrips is no longer interested in signing new documents. The wheels of the transfer mechanism thus get clogged with paper work with no incentive left for a section of the participants to help in removing the impediments. The buyers who are interested in taking delivery of the scrips and closing the transaction are left with half completed transactions which they have to continue to chase.

The deficiencies of the existing system have been well summarised by the late Shri P. J. Jeejeebhoy in his booklet 'A Blueprint of Economic Democracy'. To quote him, "This tortuous share transfer system, if at all it could be called a system, would almost seem to have been deliberately devised as an unending obstacle race. It makes it as difficult as may be for the stock market to function, while the man-in-the-street who buys and sells shares and invests his savings in joint stock enterprise is confused and confounded and all are bothered, badgered and harassed".

The principal way in which an agency like SHCIL can help prevent the clogging of the transfer mechanism is by eliminating the need for transfer deeds and for physical delivery of securities, except on exceptional basis. The mechanism in its essence will work in the same manner as one in which bank accounts are credited or debited when an account holder receives or pays money through his account. Any purchase or sale of securities will be reflected in credits and debits to the accounts of the relative holders of the securities in the books of SHCIL.

It may be noted that out of the large number of scrips in existence, the shares which are actively traded account for a small percentage of the total. for instance, in 1986, the shares of ten companies accounted for over 62% by value

of the total turnover in the Bombay stock Exchange; of those again, the shares of two companies, TISCO and Reliance, accounted for nearly 38% of the turnover. **3. In terms of number, the number of shares traded of the same ten companies aggregated 287 million of which the 3 largest by number, Reliance, Orkay and SPIC accounted for 164 million. the bulk of the actively traded scrips thus relate to a few large companies and the trade is largely accounted for by institutions, investment, companies and brokers. SHCIL's first priority will thus have to be in relation to these actively traded scrips.

Membership of SHCIL, which is presently confined to public financial institutions will also have to be extended to others such as banks, mutual funds, and investment companies and members of the stock exchange, for the system to be fully effective.

The detailed mechanism and procedures for share transfers under the new system will have to be worked out taking into account the legal requirements, costs and operational implications. After examining the various possible alternatives, SHCIL will be working out its concrete proposals and plans in this regard. At these stages SHCIL will be holding consultations so as to benefit from the advice and views of persons who have expertise and experience in share transactions business. It has been suggested that one possibility would be to resort to a system of share warrants. Against the share certificates of the members which will be deposited with SHCIL, the Corporation could ask the companies concerned to issue share warrants under Section 114 of the Companies Act in respect of shares which are actively traded. Section 114 provides:

1. A public company limited by shares, if so authorised by its articles, may, with the previous approval of the Central Government, with respect to any fully paid up shares, issue under its common seal a warrant stating that the bearer of the warrant is entitled to the shares therein specified, and may provide, by coupons or other-
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**3. Annual Report, 1986 The Stock Exchange, Bombay Table VIII.

wise, for the payment of the future dividends on the shares specified in the warrant.

2. The warrant aforesaid is in this Act referred to as a "share warrant".
3. A share warrant shall entitle the bearer thereof to the shares therein specified, and the shares may be transferred by delivery of the warrant.

SHCIL could keep the share warrants in its permanent safe custody. It could also keep its own register of accounts of all its participants. The same procedure for obtaining share warrants and keeping these in safe custody could be followed when fresh shares come up for sale through the participants.

As far as the companies are concerned, SHCIL could give them a list of the holders of shares in respect of the share warrants held by SHCIL for the purpose of dividend, rights, bonus, AGM etc. Changes in the list of holders could be effected after approval of the company concerned is obtained as under the present arrangements.

How Trading will take Place:

Under this arrangement when the security comes up for sale, the broker will first deposit it with SHCIL and get it transferred to his account. Future transfer of the security to another broker will be through a delivery order by the concerned broker. In fact a system of trading through delivery order alone would be superior to the existing system of transfer deeds accompanied by scrips in so far as it will completely eliminate the practice of keeping transactions floating through blank transfer deeds. As a delivery order is not a negotiable instrument and it confers no title to the holder, the broker will be obliged to lodge immediately with SHCIL the delivery order received from the seller because he would otherwise be running the risk of holding on to a delivery order which has no value. It would also be possible to have in-built procedures for SHCIL to keep track of the issue and execution of all delivery orders and settlement thereagainst with a view to ensuring completion of the transactions within stipulated number of days.

An alternative to the above mechanism could be for SHCIL to adopt the same procedure as the one presently followed by banks in respect of shares pledged or lodged with banks. Under this arrangement, the scrips lodged with SHCIL will be transferred in its name and SHCIL in turn will maintain ledgers showing the ownership of the shares and changes in these. Any inter se transfer of shares among the account holders with SHCIL will in that case be effected through entries in SHCIL's books as is the practice presently in the case of shares lodged with banks.

SHCIL will be taking up with the authorities concerned matters relating to any special exemptions which may be required to facilitate the above types of arrangements.

Debentures Market

Turning to debentures, there would seem to be very little need for physical possession or delivery of scrips. In the case of non-convertible debentures, the investor is interested in getting his fixed interest return at stipulated dates and the redemption of the principal on the fixed date. There are no other claims by way of bonus, rights or returns. He could treat his investment virtually like a fixed deposit, except that unlike a deposit this form of investment will have liquidity. But turning debenture investments into paperless ledger accounts, the transferability and liquidity of the investment could be improved. Companies issuing debentures could save on costs of printing and issue of the certificates and investors could avoid the trouble of having to take care of the scrips. Computer statements could keep them apprised of their holdings. Holders of blocks of debentures could be issued cheque books for effecting transfers of portions of their holdings.

Conclusion

Given on the one hand the deficiencies of the existing system for trading and transferring of shares and the virtual certainty that the system will break down when it has to deal with the anticipated large volumes of trade on the stock markets and given on the other hand modern methods for handling these transactions,

which have been well proven by experience elsewhere in the world, there is no doubt that the Indian capital market is also bound to switch over to the newer system. The role of SHCIL will be to act as an agent of change in this area and to expedite and smoothen the process of change.

COLLECTION CENTRE WISE RESPONSE

	APPL	SHARES	%	CUM %
BOMBAY	28,23,858	47,57,12,431	25.82	25.82
NEW DELHI	16,30,912	28,49,83,280	15.46	41.29
AHMEDABAD	18,84,120	24,66,73,520	13.38	54.68
CALCUTTA	6,37,041	12,28,85,578	6.67	61.35
RAJKOT	6,40,020	8,89,87,530	4.83	66.18
RAPODA	6,04,238	8,13,89,460	4.41	70.60
JAIPIUR	5,74,332	7,84,11,613	4.25	74.85
MADRAS	3,22,068	5,95,98,230	3.23	78.09
BANGALORE	3,58,373	5,89,07,795	3.19	81.28
PUNE	2,27,605	4,84,37,250	2.62	83.91
HYDERABAD	2,08,679	3,81,59,530	2.07	85.98
LUCHIANA	1,87,686	3,14,82,951	1.70	87.69
KANPUR	1,82,160	2,84,19,875	1.54	89.24
SURAT	1,69,432	2,74,45,450	1.48	90.73
INDORE	1,34,468	2,21,57,300	1.20	91.93
CHANDIGARH	98,895	1,70,02,675	.92	92.85
LUCKNOW	79,230	1,49,69,550	.81	93.66
MAGPUR	51,079	1,05,20,375	.57	94.24
AGRA	54,672	93,08,540	.50	94.74
COCHIN	51,013	87,23,770	.47	95.21
AMRITSAR	36,759	59,21,883	.32	95.54
COIMBATORE	27,407	49,65,700	.26	95.81
JAMNAGAR	40,466	46,77,250	.25	96.06
BHOPAL	20,175	45,35,315	.24	96.31
GUWAHATI	23,211	44,41,450	.24	96.55
ALLAHABAD	27,091	44,29,750	.24	96.79
BHAVNAGAR	29,546	40,60,900	.22	97.01
VARANASI	18,849	36,53,175	.19	97.21
MANGALORE	24,159	36,50,850	.19	97.40
JALANDHAR	18,335	32,95,400	.17	97.58
AHMEDNAGAR	7,973	32,75,550	.17	97.76
MADURAI	18,567	32,08,980	.17	97.93
JABALPUR	14,736	24,83,350	.13	98.07
ANAND	17,291	21,96,500	.11	98.19
VISAKHAPATNAM	8,364	20,21,450	.10	98.30
MEERUT	11,511	18,35,050	.09	98.40
JOHNPUR	13,926	17,92,950	.09	98.50
DEHRADUN	5,166	15,07,010	.08	98.58
PATNA	8,886	15,06,750	.08	98.66
NADIAU	10,552	14,40,950	.07	98.74
JAMMU	6,887	14,24,260	.07	98.81
GOA	5,126	11,56,550	.06	98.88
NAVSARI	7,563	10,67,600	.05	98.94
VIJAYAWADA	4,999	8,81,500	.04	98.98
PATIALA	4,995	8,26,100	.04	99.03
TRIVANDRUM	3,597	7,33,810	.03	99.07
JUNAGADH	7,524	7,31,300	.03	99.11
BHARUCH	4,024	6,96,220	.03	99.15
GWALIOR	3,496	6,60,950	.03	99.18
REWA	977	5,84,500	.03	99.21
ALHAR	3,883	5,56,750	.03	99.24
VIJAYAWADA	4,124	5,28,400	.02	99.27
FARIDABAD	2,647	5,19,020	.02	99.30
SRINAGAR	2,438	4,98,320	.02	99.33
MYSORE	2,969	4,86,950	.02	99.35
OTHEPS	67,621	1,18,19,786	.64	100.00
GRAND TOTAL	1,14,35,721	1,84,22,48,932	100.00	

CITY	VENLON POLYESTER, HOGANAS, CABLE CORPORATION		TOWN-WISE RESPONSE		POPULATION IN LAKHS.	
	NO. OF APPLS.	NO. OF SHARES	%	CUM %		
BOMBAY	1,08,099	2,02,46,550	25.03	25.03	82.40	
AHMEDABAD	1,79,402	1,08,15,100	13.37	38.41	27.80	
DELHI	36,907	57,25,750	7.08	45.50	62.00	
RAJKOT	28,893	45,84,700	5.67	51.17	8.60	
CALCUTTA	23,224	38,43,600	4.75	55.92	92.00	
BARODA	20,369	28,93,100	3.57	59.50	9.90	
BANGALORE	14,870	22,85,100	2.82	62.32	31.90	
JAI PUR	15,746	22,25,250	2.75	65.09	12.50	
MADRAS	9,497	15,79,650	1.95	67.03	42.90	
HYDERABAD	9,072	15,50,950	1.91	68.95	25.50	
PUNE	6,279	11,20,100	1.39	70.33	19.40	
INDORE	5,451	7,72,600	.95	71.29	9.30	
KANPUR	4,959	7,59,900	.93	72.23	17.30	
LUDHIANA	3,584	5,55,000	.73	72.96	7.60	
SURAT	3,204	4,55,900	.61	73.58	10.60	
AMRITSAR	2,281	3,32,300	.41	73.99	7.20	
LUCKNOW	1,628	2,76,100	.34	74.69	10.50	
AGRA	1,610	2,75,900	.34	75.02	10.80	
GWAHATI	1,529	2,62,800	.32	75.34	1.20	
NASIPUR	1,292	2,06,500	.25	75.60	14.60	
MEERJI	1,334	1,85,600	.22	76.06	8.60	
COCAN	1,020	1,75,600	.21	76.29	10.20	
NASIK	572	94,000	.11	76.55	9.30	
COIMBATORE	544	92,000	.11	76.66	15.40	
ALLHABAD	506	71,200	.08	76.75	7.70	
MYSORE	390	68,600	.09	76.84	7.60	
PATNA	269	54,900	.06	76.90	11.20	
VISAKHAPATNA	353	54,100	.06	76.97	8.00	
VARANASI	317	48,300	.05	77.03	10.00	
JABALPUR	281	45,500	.05	77.09	9.90	
SOLAPUR	103	20,000	.02	77.14	7.70	
MADURAI	108	16,400	.02	77.17	16.40	
DHARBAD	56	8,000	.01	77.19	10.70	
OTHERS	1,29,266	1,90,72,850	23.55	100.00	7013.30	
GRAND TOTAL	5,13,004	8,08,57,930			7650.00	

COMPANIES OF 1995 TO 1997

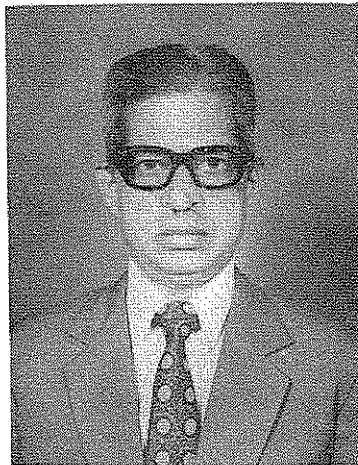
COMPANIES OF 1996 AND 1997

COUNTRY WISE ANALYSIS

COUNTRY WISE ANALYSIS

COUNTRY	APPL	SHARES	%	APPL	SHARES	%
AFGHANISTAN	1	5,000	-07	1	5,000	-02
BANGLADESH	11	4,46,400	-02	11	4,46,400	-02
BHUTAN	7	1,06,000	-02	7	1,06,000	-01
NEPAL	12	1,20,500	-10	12	1,20,500	-01
SRI LANKA	43	5,88,300	-07	43	5,88,300	-01
TOTAL						
ABU DHABI	4,546	4,35,01,100	6.47	4,546	4,35,01,100	6.47
AJMAN	103	9,63,700	-14	103	9,63,700	-14
BAHRAIN	4,460	4,29,01,000	6.38	4,460	4,29,01,000	6.38
DUBAI	5,003	8,11,49,300	13.14	5,003	8,11,49,300	13.14
FUJAIRAH	113	12,82,400	-10	113	12,82,400	-10
IRAN	94	12,41,800	-19	94	12,41,800	-19
IRAQ	49	3,87,900	-95	49	3,87,900	-95
KUWAIT	6,312	6,90,89,100	19.29	6,312	6,90,89,100	19.29
LIBYA	11	11,06,800	-17	11	11,06,800	-17
OMAN	4,630	5,92,60,000	8.83	4,630	5,92,60,000	8.83
CATAP	3,301	2,82,67,100	4.21	3,301	2,82,67,100	4.21
QATAR	12	85,800	-01	12	85,800	-01
RUSSIA	207	22,43,200	-31	207	22,43,200	-31
SAS AL KHAYMA	7,167	5,51,31,500	8.22	7,167	5,51,31,500	8.22
SAUDI ARABIA	1,530	1,73,24,500	2.54	1,530	1,73,24,500	2.54
SHARJAH	41,567	41,49,50,000	61.24	41,567	41,49,50,000	61.24
TOTAL						
BRUNCI	35	2,75,100	-04	35	2,75,100	-04
HONG KONG	306	2,08,57,000	3.01	306	2,08,57,000	3.01
INDONESIA	231	33,20,700	-50	231	33,20,700	-50
JAPAN	42	7,97,500	-11	42	7,97,500	-11
KOREA	4	72,000	-01	4	72,000	-01
MALAYSIA	200	20,93,900	-30	200	20,93,900	-30
NEW ZEALAND	110	11,40,000	-16	110	11,40,000	-16
THAILAND	65	29,93,700	-01	65	29,93,700	-01
TOTAL	1,302	4,23,24,600	6.31	1,302	4,23,24,600	6.31
AUSTRIA	8	2,47,000	-04	8	2,47,000	-04
BELGIUM	47	5,31,000	1.32	47	5,31,000	1.32
CYPRUS	14	1,03,500	-02	14	1,03,500	-02
DENMARK	0	00,000	-01	0	00,000	-01
FRANCE	22	56,000	-13	22	56,000	-13
GERMANY	6	8,37,500	-01	6	8,37,500	-01
GREECE	6	37,200	-01	6	37,200	-01
ITALY	1	1,000	-01	1	1,000	-01
JORDAN	1	40,000	-01	1	40,000	-01
LUXEMBOURG	1	2,500	-01	1	2,500	-01
NETHERLANDS	0	00,000	-01	0	00,000	-01
HONGKONG	2	2,05,000	-03	2	2,05,000	-03
INDONESIA	2	10,000	-01	2	10,000	-01
SPAIN	43	7,00,000	-11	43	7,00,000	-11
TOTAL	2,692	5,32,94,920	7.94	2,692	5,32,94,920	7.94
GRAND TOTAL	56,733	67,10,93,150	100.00	56,733	67,10,93,150	100.00

Mr. M. R. Mayya



Mr. M. R. Mayya

Mr. M. R. Mayya is one of the seniormost Officials of the Indian Economic Service of the Government of India. During his career he has been on the Governing Boards of most of the Recognised Stock Exchanges in India. He is presently the Executive Director of the Bombay Stock Exchange. He has brought about several reforms in the working of Stock Exchanges. He has represented India in international seminars. He has written several articles and delivered many lectures on matters relating to capital markets. He is the country author for India on "International Securities Regulations".

Regulation of Stock Markets and Investor Protection

by

Mr. M.R. Mayya

Executive Director,

**The Stock Exchange,
Bombay**

Proper regulation of the market and due protection of the investors are the sine qua non of a healthy functioning of a Stock Exchange anywhere in the world at any point of time. Control and regulation over the functioning of Stock Exchanges have come only when either the markets have not been regulated properly or the interests of the investors were affected adversely. The Great Crash of the Black Thursday, the 29th October, 1929 in the U.S.A. resulted in the enactments of the Securities Act of 1933 and the Securities Exchange Act of 1934. A far more severe crash of Thursday, the 19th October, 1987, is bound to lead to tightening of controls and regulations and several investigations into the causes of the debacle are already on. Even in our own country, it was that which led to the initial regulation of the Stock Exchanges in the erstwhile State of Bombay by placing the

Bombay Securities Control Act of 1925 on the statute. This was subsequently followed by the Securities Contracts (Regulation) Act of 1956 of the Union Government with the subject of Stock Exchanges being included in the Union List in the Constitution of India and the frontiers of regulation being extended to the whole country.

Two-tier Layer of Regulation

We have in this country a two-tier layer of regulation, one by the Government and the other by the Stock Exchanges themselves. The governmental regulation is mainly confined to application of the various sections of the S.C.(R) Act to the different parts of the country, grant of recognition to Stock Exchanges, approval of Rules/Articles, Bye-laws and Regulations of Stock Exchanges, making or amending suo moto Rules and Bye-laws of Stock Exchanges, acting as an appellate authority in respect of listing and delisting of securities and suspension of trading in securities, appointment of key personnel of the Stock Exchanges like the President, Vice-President, Chief Executive Officer, Public Representatives and government nominees, issue of directions and guidelines relating to the entire gamut of working of Stock Exchanges, redressal of grievances of investors, etc. Under the S.C.(R) Act, the powers of the Government are far wider than these. Government can make enquiries into the affairs of Stock Exchanges and their members, supersede the Governing Boards of Stock Exchanges, suspend business at Stock Exchanges and even withdraw recognition granted to them although recourse to these powers is not normally made. By and large, Government has evolved the philosophy that Stock Exchanges have themselves to regulate their own activities and that its functions are mostly of an overseeing nature. This is in tune with the systems and methods by most of the countries of the world which have Stock Exchanges. Even in the U.S.A., which has one of the strictest framework of governmental regulation, Stock Exchanges have been granted the requisite autonomy to regulate their own day-to-day affairs. This is mainly so not because Stock Exchanges are considered to be the best judges of the situation but because they are in possession of full information at any given situation and time is of supreme importance in the control and regulation of Stock Exchanges. Delay in action even by a few hours, not to speak of days, can cause disaster in the market.

Regulation by Stock Exchanges

Regulation of the stock market by the Stock Exchanges covers the entire gamut of the operations, beginning from the enrolment of members and their authorised assistants, enlistment of securities of companies and disciplining their activities all the while, besides exercising control and regulation over trading.

Membership of Stock Exchanges is subject to severe monetary constraints. A person has to purchase a card which currently costs Rs. 7.51 lakhs at the Bombay Stock Exchange. He has also to pay a security deposit of Rs. 2 lakhs. Besides, he should have adequate working capital and a working place. The educational and professional qualifications, which are at a low level today, will progressively be raised in the years to come. Above all, he is subject to a strict code of conduct and any misconduct or unbusiness like or unprofessional conduct would render him liable to disciplinary action ranging from warning to expulsion depending upon the gravity of the offence. Much to their chagrin about one fourth of the members, of the Bombay Stock Exchange come under some form of disciplinary action or the other every year.

Listed Companies

Companies seeking enlistment of securities on Stock Exchanges have to comply with a very strict schedule of listing requirements beginning from the requirement of public offer till the execution of Listing Agreement comprising 41 clauses. The Agreement is in the form of a covenant designed to facilitate smooth and orderly trading in the market and to protect the interests of shareholders and others who invest or deal in securities. The Agreement, inter alia, provides for prompt transfer, registration, sub-division and consolidation of securities into market lots without any special charges, notifying the Stock Exchanges immediately about the total turnover, gross and net profits, appropriations including dividend distribution, increase of capital by issue of right or bonus shares, any proposed change in the general character and nature of business etc., submission of annual reports, notices and circulars sent to shareholders, annual schedules showing the distribution of securities etc., publication of half-yearly reports about the working and

earnings of the company, offer of right issues to the shareholders together with the right of renunciation to be accepted/recorded within a reasonable time, not being less than four weeks, payment of dividend warrants/payable at par at certain specified centres, comparable offer to the minority shareholders whenever somebody secures the effective control of the management of a company or acquires 25% or more of the voting capital of the company at a price not lower than the price at which the shares of the company have been acquired, etc. With a view to ensuring that a listed company does not act in a flippant manner, the Agreement also ordains that the company, unless the Stock Exchanges agree otherwise, will not without the previous permission of the Central Government withdraw its adherence to the Agreement.

Unlike the member of the Exchange who can easily be subjected to various forms of disciplinary actions like warning, reprimand, censure, fine, withdrawal of all or any of membership rights, suspension and expulsion, the only two actions that can be taken against an errant listed company are suspension of dealings in their securities and delisting their securities both of which are against the interest of the shareholders. The Bombay Stock Exchange, however, made a beginning in 1987 by suspending dealings in the securities of four companies for a token period of one to three days and this did create quite a stir in the corporate world. There is a need to clothe the Stock Exchange authorities with powers to fine such companies and in suitable cases even to launch prosecutions in Courts of Law against the company and its Directors.

Control and Regulation over Trading

The basic objective underlying control and regulation over trading in securities is to prevent excessive speculation and defaults.

Excessive speculation can and does cause wide and sharp fluctuations in prices to the detriment of the market as a whole while defaults shake the very foundation of the functioning of the Stock Exchange. It is, however, rather difficult to assess in precise terms as to what is the desirable degree of speculation and what is not. Any quantitative approach like the proportion of deliveries to the volume of trading or of the extent of fluctuations to the turnover can be exercised in futility.

Paradoxical as it may appear, generally a larger volume is accompanied by a narrower range of price fluctuations. It is precisely because of this that the movement of prices on the Bombay Stock Exchange, which accounts for about two-thirds of the business of the country, is more orderly with oscillations being confined to a narrower groove, as compared to other Exchanges. Nonetheless, it is absolutely necessary to curb excessive speculation, both on the bullish and bearish sides and what is more important, in time, and at times a qualitative approach like the feel of a situation may be more useful in arriving at a conclusion in the matter. This is not to say that the various monitoring mechanisms evolved to constantly gauge the market activities are not helpful. In fact, at the Bombay Stock Exchange daily reports of operators having outstanding business above 0.5 per cent of the paid up capital of a company and of the major ten operators, five on the purchase side and five on the sale side, in a scrip whose outstanding position is above 2.5 per cent of the paid up capital of any company are, among other things, being constantly monitored and these have proved to be extremely helpful in tracking down speculative activities.

Defaults which could be due either to excessive speculation or to entering into commitments beyond one's financial capacity or to a combination of both or even to sheer wanton volition not to honour the commitments, all of which are deplorable, the last one being the most disgraceful, have a shattering effect on the market. While all the other members of the Exchange who have had contractual obligations with the defaulting member have to bear these losses in respect of market liabilities, the clients of the defaulting member have to forego their hard-earned savings. Customers' Protection Fund, which guarantees payment to a limited extent in respect of genuine investment claims, is only a palliative and not a solution. While to ensure total prevention of defaults in a Stock Exchange is almost impossible, certainly all attempts should be made to minimise the same.

Regulation and control are mostly confined to trading in specified shares in which transactions can be carried forward from one settlement period of 14 days to another. The facility of carry forward has an attendant risk attached to it and it is necessary to ensure that this risk is duly covered by various devices.

Trading in specified shares is at present conducted at the four major Stock

Exchanges of Bombay, Calcutta, Delhi and Ahmedabad which have 70, 51, 32 and 18 shares respectively in this group. Eliminating the common scrips, the total number of shares involved is 122 out of about 7500 stock issues of about 5000 companies listed on these Exchanges. About 75% of the turnover on these Exchanges is accounted for by the specified shares.

For a share to be in the specified group, it must satisfy certain distinct norms. The paid-up capital of the company should be at least Rs. 5 crores with a market capitalisation of Rs.10 crores. There should be a large number of public shareholders, preferably more than 20,000. The company must be a growth-oriented one with a consistent dividend record. The share should have been listed for a minimum period of three years. Above all, there should be brisk trading in the share, indicative of investor interest. There is no permanency attached to the list. It is constantly reviewed, with additions and deletions taking place once in six months or so. Managements of companies have no say whatever in the determination as to whether or not a share must be in the specified group. This is the sole prerogative of Stock Exchange authorities for whom public interest and interest of trade are the only guiding factors for the determination of the list.

Contrary to the general belief, Stock Exchanges have several weapons in their armoury to ensure that trading is being conducted in an orderly and systematic manner and that settlements take place in time and without any hitch. The major weapons deployed for this purpose are explained in the following paras.

Margins

Three types of margins are deployed to regulate the market. First, daily margins are collected in respect of every contract outstanding at the end of the day. These are normally payable in about 30 to 35 scrips out of the total of seventy scrips in the specified group. Rates of margins vary from about 10% to 25% in respect of about 15 volatile scrips and 5% to 10% with regard to others. In a rising market, bears pay at about 50% of the rates payable by bulls and the position is reversed in a falling market. The higher rates against bulls in a rising market and against bears in a falling market are recognised as a price corrective measure dissuading

the bulls from purchases when the market is buoyant and the bears from sales when the market is depressed. There is no fixity about these rates and are often changed to be in tune with the constantly changing market situation. Calling for stability in these rates, as is being done by a section, is displaying ignorance of the objective of the margin requirement.

Daily margins are payable on the gross position of a member i.e. cumulative aggregate of purchases and sales outstanding at the end of the day entered into by the member with other members in the market either on his own behalf or on behalf of his clients without setting off the purchases of the clients against the sale of another and vice versa. Besides, they are also payable on the transactions put through directly between clients of a member and on his transactions with his clients as a principal. Daily margins are, however, not required to be paid for purchases in respect of which an approved Bank gives the Clearing House an irrevocable guarantee that it will take delivery of the securities on the due dates and for sales if the securities tenderable against such sales are deposited with the Clearing House of the Stock Exchange or if an approved Bank gives the Clearing house an irrevocable guarantee that such securities are in its custody and will be delivered by it on the due dates. Thus purchases and sales which result in actual delivery can get themselves exempted from payment of daily margins. Members are also given the facility of adjusting the margin for the business done in the one security against the business done in any other security. Actual calculation of daily margin is quite a cumbersome matter leading at times to shortages in payment even by members who desire to adhere to these requirements scrupulously. In all such cases routine penalty at the rate of 2% of the amount is levied on such defaults besides collection of margin money and withholding the same for the period of a fortnight. Habitual offenders are, however, subjected to more severe punishment, including suspension.

The second type of margin is the carry-over margin payable by members on the aggregate of the net balance of purchases and of sales carried over from one settlement to another on account of each of their clients and on their own account as principals, in all the specified shares, irrespective of whether or not daily margins have been made applicable to these shares. While the minimum rate of carry-over margin is 3% of the making-up price i.e. the price at which the

transactions are carried over from one settlement to another, generally it is about 5% to 25%. As in the case of daily margin, the rate of carry over margin is higher in respect of purchases in a rising market and in respect of sales in a falling market. In fact, a part of the profit is always impounded, the attempt thus being to use this weapon also as a price corrective measure. As far as possible the rate of carry over margin is not pegged below the daily margin rate. While calculating the carry over margin the daily margin already paid, however, gets subsumed.

The third type of margin is the adhoc margin which are collected from individual members who are indulging in excessive speculation or in speculative activities beyond their means. At the Bombay Stock Exchange, however, all members having an outstanding position above Rs. 3 crores are required to deposit adhoc margins at the rate of 10% of the business above Rs. 3 crores as a matter of routine. The weapon of adhoc margins needs to be used very tactfully as at times insistence of collection of adhoc margins can force a party to default rather than pay these margins.

In addition to adhoc margins, further adhoc margins are collected from members in case of a precipitate rise or fall in the price of any security.

Members are fully entitled to collect the margins from their clients. While collection of carry-over margins is done as a matter of routine, members are reportedly experiencing some difficulty in collection of daily margins as all clients have not got used to this requirement.

Margins-daily, carry over and adhoc-have proved to be the most potent weapon of regulation. The Bombay Stock Exchange had at the height of boom in 1985 impounded as much as Rs. 25 crores by way of margins and that was mainly responsible for prevention of any default despite the unprecedented rise in share values.

There is a tendency to confuse our system of margins with margin trading in the U.S.A. In the U.S.A., a stock bought must result within five business days in taking of delivery and full payment for the same has to be made. There is no provision for carry-over as in India. The investor has the facility of paying cash upto

the stipulated extent which is set by the Federal Reserve Board and which is at present 50% and the balance 50% is paid by the broker through a "broker loan" obtained from a bank and collateralized by the purchased stock. Thus full payment is made for the stock purchased while in India, differences are settled between the contract rate and the settlement price (technically called the making-up price) fixed by the Stock Exchange authorities on the last day of the settlement period on the basis of the closing prices of the day. The margin money required to be collected here is a cover against the likely adverse movement of prices while the margin money in the U.S.A. is the amount funded by banks into the security industry and there just cannot be any comparison between the two. Yet it is strange that this is being done, even by the erudite.

Limits on Business

Limits on the outstanding business of a member are imposed with a view to preventing destabilisation of the market because of the impact of large holdings on the movement of prices. A large market with a number of players is always a more stable market than one with a few players. At the Bombay Stock Exchange, the limit is Rs. 3 crores on the aggregate of all outstanding purchases and sales which can be carried forward from one settlement period to another and Rs. 5 crores at any point of time, irrespective of whether such business results in actual delivery or not.

At times, particularly during periods of bullish fervour or bearish grip in the market, limits are also imposed on the total volume of business of a jobber. The object is that the facility of jobbing, without which market operations become difficult, should not be misused to accentuate the trend in the market. In 1987 when the market was generally ruling depressed, a limit of Rs. 5 lakhs per jobber which was subsequently raised to Rs. 10 lakhs was in operation at the Bombay Stock Exchange most of the time.

Prohibition of further Dealings

A large volume of outstanding business in any scrip at any point of time can prove to be a constant danger to market stability. It is, however, rather difficult to specify

the plimsoll line beyond which outstanding business should not be permitted to be accumulated as this depends on a number of constantly varying factors like pattern of holdings, floating stocks, etc. Nonetheless this is a very potent weapon often used by Stock Exchange authorities to control trading. Dealings in the share of the company concerned are then permitted only with the outstanding business being however, permitted to be liquidated on a spot delivery basis/. Normal trading is resumed only after the outstanding business gets reduced to a reasonable level. At times compulsory liquidation of the outstanding business by 20 percentage points in each settlement so as to reach the zero level of outstanding business in the course of about three months is also ordered.

It would be a good guideline to follow that whenever outstanding business in any security exceeds say 5% of the paid-up capital, then automatically further dealings in the security should be prohibited except for the purpose of liquidation and trading in the security should be permitted only on a spot delivery basis. Resumption of normal trading may be permitted only after the outstanding business shrinks to a level below say 2.5% of the paid-up of the security. Such automatic checks with suitable further modifications, if need be, can allay apprehensions of unbridled speculative activities having a sway over the market.

Floor and Ceiling Prices

Steep declines and sharp advances in prices need to be prevented as they can totally upset the applecart and create insoluble problems. This can be done, albeit temporarily, by fixing floor prices in the case of declines and ceiling prices in the case of advances. Such floor and ceiling prices give time for the market for a pause and a rehabilitation and it has generally been the experience that prices do tend to correct themselves by this measure. This cannot, however, be a long-term measure as prices in the ultimate analysis have to be determined by the normal forces operating in the market and cannot artificially be propped up or pegged down and any attempts to do so would lead to unhealthy practice of the premia above the ceilings and discounts below the floors being privately settled.

Following a sharp decline in prices in November, 1986, the Bombay Stock Exchange authorities had fixed the closing prices of 30th November, 1986 as the

floor prices and these were operating from the 1st December, 1986 to 19th December, 1986 when the prices started recovering and were quoted above the floor levels.

Prohibition on Speculative Transactions

Speculative transactions i.e. transactions which do not result in delivery, popularly known as short sales and long purchases, lend breadth and liquidity to the market absorbing large orders of purchase or sale with relatively narrow bulges in prices. Without these transactions, market operations become difficult, often aberrated and disjointed. However, there are occasions when these transactions can and do aggravate the situation, although it is rather difficult to pinpoint such situations. Nonetheless one can perhaps say that a sustained period of boom or a prolonged bear phase could be such occasions when prohibitions on speculative transactions could be imposed to resile the market from the continuing trend it is aserting itself into.

Except for a brief period from the 12th May, 1987, till 23rd June, 1987, there has been a ban on speculative transactions right from the 9th March, 1987 till the 19th October, 1987. While the ban was limited to short sales only during the period, 9th March, 1987, to 11th May, 1987, the period from the 24th June, 1987 witnessed the ban on both short sales and long purchases. As the bearish sentiment was rather too pronounced, the Stock Exchange authorities had even imposed the drastic requirement of physical delivery of shares within 24 hours initially which, however, was raised to 72 hours subsequently.

Trading on account.

Insistence on physical delivery of all transactions had virtually stultified the market with the turnover tumbling down to less than one-third of what it used to be in the normal times and thereby rendered the market less liquid. Although the

measure did have the desired effect of moderating the price fall, the growing illiquidity in the market became a matter of concern. A new concept of trading on account on the lines of the current pattern of trading on the London Stock Exchange was developed by the Informal working Group on "Current system of restrictions on Trading in Stock Exchanges" set up by the Controller of Capital Issues with Dr. S. A. Dave, Executive Director, Industrial Development Bank of India, as the convenor. Trading on account permits free trading during a settlement period with all the transactions entered into during the period either resulting in delivery or being offset by opposite transactions. There cannot, however, be any carry forward of transactions from one settlement to another. Trading on account has been operative since the 22nd October, 1987. Although the volume of business continued to be low initially, the turn-round in prices from the 11th December, 1987 did bring about an improvement but only to a limited extent. It is only the carry-forward facility which can improve the liquidity as the operators having continuously an outstanding position in the market are always on the look out for covering their position either to book profits or to cut losses. It is again the facility of not taking or giving delivery and also of not being required to liquidate the position before the end of the settlement that facilitates free entry of operators into the market. These speculative activities with proper trammels and controls act as a constructive and dynamic force in forging a broad and liquid market.

Band of Limits

Part and parcel of trading on account recommended by the Dave Committee was introduction of the concept of band of limits on movement of security prices to reduce the hazards involved in sharp fluctuations and make the movement more orderly and evenly. Limits were imposed not only on the daily two-way movements in prices as compared to the previous day's closing quotation, but also on the extent of fall or rise during a settlement period in relation to the making-up price of the previous settlement period as under :

Market price of the share	Daily limit of price fall or price rise	Settlement period limit of price fall or price rise
Upto Rs. 50	10%	20%
Above Rs. 50 upto 100	7.5%	15%
Above Rs. 100	5%	10%

With a view to providing a better leeway for the upward movement of prices, the settlement period limit of price rise was doubled from the 30th November, 1987. In respect of shares of the market price upto Rs. 50, the settlement period limit of price rise was thus raised from 20% to 40%, for those above Rs. 50 upto to Rs. 100 from 15% to 30% and for those above Rs. 100 from 10% to 20%.

Whenever the price of a share shows a tendency to cross the limits set by the above bands, the share is transferred to spot delivery list for that settlement period and is retransferred to the specified group only in the next settlement.

Sacrosanct as the above limits are, they are required to be altered at times due to a change in fundamental factors warranting a change in the level of prices. Broadly, the following factors act as guidelines for relaxing the price bands :

- (i) Working results of companies, including half yearly results
- (ii) Deliberations at the Annual General Meetings;
- (iii) Take-over bids;
- (iv) Strikes and Lock-outs;
- (v) Changes in the excise and customs duties;
- (vi) Changes in administrative prices.

It is rather premature to pass any value judgement on the efficiency of the price bands as an instrument for regulation of the market. Yet the fact that once the limits are reached an operator is denied the right to cut short his losses which might

result in his inability to meet the market liability subsequently is a factor which needs consideration.

Closure of the Market

In extreme cases, and only in extreme cases, when it is felt that the market is in a totally demoralised condition, closure of the market is ordered so as to give a pause for the market to reassess its own mood and to correct itself. Opinions on the sagacity of such a step are, however, divided. Except the roller coaster market of Hong Kong, none of the global markets closed despite the worst ever disaster on the 19th and 20th October, 1987 and even the talk of the closure of the market was considered to be "crazy".

Regulation of Cash Market

Although the regulatory weapons are generally applied only to the specified group of shares to control speculative excesses and not to the non-specified group of securities as transactions in this group have generally to result in delivery, speculative activities threatening the stability of the market are at times witnessed in this group too. The regulatory measures, particularly margins and shifting the shares to spot, are then extended to this group and these are continued till such time normalcy gets restored in trading.

Vital as the instruments of regulation are without all of which no market should be allowed to function, it is pertinent to note that clogging the market with too stiff a dose of correctives would stullify the market rendering the smooth working rather difficult. All these measures should act as checks and balances, to control and regulate excesses and not as obstacles and roadblocks to the orderly and systematic functioning of the market which always acts and reacts to a host of factors constantly changing and which is propelled by the collective judgement of hundreds and thousands operating simultaneously on the market. The market is like a national poll and any attempts to throttle the functioning of the market is like attempting to aberrate the judgement of the people.

Resiliency of Indian Stock Markets

The Indian Stock Markets have displayed a remarkable degree of poise and stability, thanks mainly to the checks and balances inbuilt in the system and the various timely and effective measures taken by the Government and Stock Exchange authorities from time to time. As per a study conducted by the Bombay Stock Exchange the average annual fluctuations of all India Index Number of security prices of ordinary shares of the reserve Bank of India was only 22.1% during the period 1980 to 1986 which was on par with the corresponding figures of 22.0% of the London Stock Exchange and 23.9% of the New York Stock Exchange and well below the average of 30.2% of 15 leading countries of the world.

Contrary to the general belief, it is the specified group of shares subject to total control and regulation that has proved to be more stable than the non-specified group. The average annual range of fluctuations of ten leading scrips in this group on the Bombay Stock Exchange during the period January, 1984 to June 1987 was 50.8% as against 53.5% in respect of ten leading scrips in the non-specified group during the same period. Theoretically, therefore, there is a case for extending the list of specified shares.

Investor Protection

The cardinal objective of regulation of Stock Exchanges the world over is protection of interests of the investors and that is the objective in this country too. In fact, no Stock Exchange is granted recognition by the Government of India unless its Rules, Bye-laws and Regulations are in conformity with such conditions as may be prescribed with a view to protecting the interests of the investors.

The various provisions embodied in the Rules, Bye-laws and Regulations of Stock Exchanges to protect the interest of the investors include consent of the client before a member enters into a contract with him as a principal, issue of a contract whether as a principal or as an agent after the contract is entered into, right of the client to close out an unfulfilled contract through any other member of the Exchange, lodging of a complaint against any member who fails to implement the stockbroking business with the Stock Exchange authorities who can take disciplinary action including suspension against the member if they are satisfied about the complaint, reference to arbitration, etc. Lack of adequate knowledge on the part of the investors in this behalf, however, erodes greatly the protective cover. Added to this is perhaps the hesitancy on the part of the Stock Exchange authorities to be totally impartial in matters of disputes between a member and his client despite invocations in this regard from Government.

Inadequate as the shield to cover the interest of investors is, the problem becomes

a lot complicated because of the mediation of the sub-brokers who are not registered and on a rough reckoning the 3000 members of Stock Exchanges have atleast 20,000 such sub-brokers. Authorised assistants who act as sub-brokers numbering about 10,000 are, however, subject to some degree of control as they are registered with the Stock Exchanges. These sub-brokers, including the authorised assistants, are entitled neither to issue contracts nor bills relating to contracts. Yet they do so, although these are illegal, giving apparently the stamp of authority to such contracts. The delinquent among the sub-brokers collect all the credits from the member and retain with them most of these credits without passing on the same to the clients and thereafter vanish from the scene without any trace. Members invariably plead their inability to do anything in the matter driving the hapless investor to total grief. The Bombay Stock Exchange has recently issued a press note drawing the attention, of the public to the correct legal position in the matter with a warning not to be misled by the sub-brokers. This has, however, created a serious problem to the members as several of them do not have the wherewithal to service the clients built through sub-brokers. The question of permitting these sub-brokers to issue contracts by registering them and even enrolling them as associate members by amending suitably the status is a matter requiring urgent attention.

Be that as it may, Stock exchanges have evolved a number of measures to alleviate the grievances of the investors and to grant them progressively greater degree of protection. Some of major measures in this regard are dealt with in the following

paras.

Investors' service cell

The Bombay Stock Exchange had established a Complaints cell about 7 years ago to look specifically into the complaints of investors. In pursuance of a Government directive, the Cell was not only rechristened as the Investors' Service Cell in 1986 to demonstrate clearly the service character of the Cell but also strengthened with a senior officer leading the cell to render expeditious service to the investors. About 2,000 complaints are received by the Cell every month and out of this about 94% are against listed companies and the balance against stockbrokers. In 1987, the Exchange received in all 22,508 complaints - 21,169 against listed companies and 1,339 against members. The complaints against companies mainly related to non-receipt of refund/allotment advice, non receipt of securities, transfer of securities, non receipt of interest/dividend, non-receipt of brokerage and underwriting commission, etc. Against members the complaints are primarily about non-receipt of securities bought, non-receipt of sale proceeds, , non-receipt of payment of profits, etc.

The Investors' Service Cell tries its level best to redress the grievances as expeditiously as possible. In fact, in all the communications to the investors they are requested to contact the cell if their grievances are not redressed within a reasonable time, thereby clearly indicating to them the earnestness of the Cell to

resolve the problems of the investors. Out of the 21,169 complaints received by the cell in 1987, 16,557 complaints were disposed of.

When the attempts of the cell to resolve the dispute between a member and his client do not succeed due to claims and counterclaims by the disputants, the client is requested to refer the matter to arbitration. Such cases are, however, relatively few.

Arbitration

A client or a member can refer any claim, difference or dispute with a member or a client, as the case may be, for arbitration under the Rules, Bye-laws and regulations of the Stock Exchange. Arbitration has to be conducted by two members of the Exchange, one to be appointed by each party. In case of any difference between the two arbitrators as to the award, they can appoint an umpire from among the members of the Exchange. During 1985, 1986 and 1987, 40, 68 and 136 arbitration cases have been filed out of which 25, 21 and 48 cases respectively have been disposed of.

Although arbitrators are normally required to give the award within four months, quite often there is delay due to the protracted nature of the proceedings which has a frustrating effect on the claimants. We at the Bombay Stock Exchange are seriously trying to evolve a shorter system of these proceedings so that justice is

administered in time.

There is a feeling that members of the Exchange, who alone are entitled to sit as arbitrators, may not always be as objective as is required. This is not normally true. Yet as dispensation of justice has not only to be objective but also appears to be so, the question of having outsiders like retired judges having the requisite expertise to act as arbitrators needs favourable consideration.

Customers' Protection Fund

Whenever a member of a Stock Exchange is declared as defaulter, the net assets remaining in the hands of the Defaulters' Committee after defraying costs, charges and expenses relating to the realisation of these assets are utilised to satisfy first the claims of the Exchange and the clearing House run by the Exchange and then the admitted claims of members of the Exchange against the defaulter on a prorata basis. Only if any surplus is left thereafter, the claims of the clients of a defaulter member are considered by the Defaulters' committee. The clients can, no doubt, go in for arbitration with the Exchange in respect of their claims and obtain awards in their favour and thereafter get the same filed in a Court of Law for decree. The decrees, however, cannot generally be executed as the defaulter invariably disposes of all assets before he is declared a defaulter.

Lack of suitable protection to the clients in the event of a member of a Stock Exchange being declared a defaulter has proved to be a major bottleneck in the flow of funds into industrial securities. Ministry of Finance had, therefore, directed the Stock Exchanges of the country to set up a Customers' Protection Fund. The Bombay Stock Exchange was the first to set up such a Fund. Established in October, 1986, the Customers' Protection Fund of the Exchange is patterned on the lines of the Securities Investor Protection Corporation of the U.S.A. and the Stock Exchange Compensation Fund of the London Stock Exchange. The fund is financed partly by way of a levy on the turnover of members collected at the rate of one rupee for every Rs. 10 lakhs and partly by way of contribution from the listing fees collected at the rate of one per cent. The Fund has at present about Rs. 3 lakhs to its credit. The Fund is being administered only for the benefit of the clients of the defaulting members of the Exchange and their beneficiaries in respect of genuine investment claims. The compensation that may be paid in respect of any single client is limited to Rs. 10,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the Fund. While there is no ceiling on the amount of compensation that may be paid from the Compensation Fund of the London Stock Exchange, the Securities Investor Protection Corporation of the USA limits the payment to a single customer to \$5,00,000 out of which claims on cash, as distinct from claims for securities, would not be more than \$1,00,000. The Securities Investor Protection Corporation has a line of credit upto \$500 million from the banks, besides \$ 1 billion from the Securities and Exchange Commission which in turn can borrow the same from the U.S. Treasury. A similar dispensation in this country can help in grant of increased compensation from the Customers' Protection Fund.

Odd Lots

Odd lots constitute a major constraint of the Indian investors. Out of a total market capitalisation of about Rs.25,000 crores equities worth about Rs.4,000 crores are in odd lots. About 70% of the holdings of a leading company are in odd lots. Investors normally receive 15% to 20% less than the market price for

their sales and have to pay 15% to 25% more than the market price for their purchases of odd lots. Schemes evolved by some of the agencies and companies to fetch a better price for the investors have not proved to be much of a success.

In a significant move to alleviate the hardship of investors, the Bombay Stock Exchange has appointed 16 members as authorised odd lot dealers with effect from the 1st September, 1987. According to the norms laid down by the Exchange, these dealers have to pay to the sellers at rates prevailing on the previous day minus 10% in the case of securities whose prices are upto Rs.40, minus 7.5% in the case of securities whose prices are between rs.40 and Rs.100, minus 5% in the case of securities whose rates are more than Rs.300. To beginwith, the scheme is confined to companies whose registered offices are situated in Bombay. Later the scheme will be extended to companies whose registered offices are outside Bombay.

A separate trading session has also been arranged every Saturday beginning from January 1988 to facilitate odd lot dealings amongst members themselves. These sessions, which will help in consolidation of odd lots into trading lots dispensing with the requirement of sending odd lots to companies, have proved to be very popular.

It is heartening to observe that Delhi and Calcutta Stock Exchanges have also initiated steps similar to those adopted by the Bombay Stock Exchange to facilitate consolidation of odd lots into trading lots. Other Stock Exchanges are also expected to follow suit.

Laudable as these efforts are they need to be supplemented for solving the problem fully, companies may themselves be permitted to purchase the odd lots of their own shares preferably at the ruling price with the safeguard of prior approval of the General Body to prevent any misuse by the Board of Directors. These shares can then be reissued in marketable lots, if need be. Similar provisions exist in countries like the U.S.A. and U.K. and there is no reason why we should not emulate the same. Companies Act, 1956 will, ofcourse, have to be amended for the purpose.

Lack of Liquidity

The conception that a listed security is generally tradeable is not correct. Lack of liquidity, is a major problem haunting the investors. In fact, 50% of the listed securities virtually remain untraded in any year and many of the untraded shares remain so for years together. Even in bulk of the remaining securities, transactions are few and far between with the bid and offer quotations showing a wide gap, at times, as much as 25% to 30%.

The decision recently taken by the Presidents of the Stock Exchanges to insist on a sponsoring broker for a company with an issued capital of Rs. 3 crores or more seeking enlistment on stock exchanges and more importantly for the sponsoring broker to act subsequently as a market maker is welcome. Translation of this decision into practice needs, however, to be watched with interest.

A bold attempt to solve the problem of liquidity has recently been launched by the Bombay Stock Exchange with the introduction of the Bid and Offer Online System for Thinly Traded Securities (BOOSTS) 490 securities out of a total of about 3,500 listed securities which are frequently traded are not considered in this system. Bids and offers in marketable lots on the basis of the information provided by the members would be captured and displayed by the system. It would also match the bids and offers at the same rate. The bids and offers would remain valid for a period of 15 calendar days. Members are, however, given the option of cancelling their bids and offers or changing the rates or quantities of only unmatched bids and offers. The system, which is expected to be a success, will usher in a new area in trading on Stock Exchanges.

Yet another method to improve liquidity would be to appoint market makers as in developed countries in respect of these thinly traded securities. A beginning can be made by having such market makers in respect of a security with a paid up capital of say Rs.3 crores or more supply of securities and liberal grant of credit by the commercial banks, preferably at a concessional rate, to these market makers and grant of fiscal incentives by way of treatment of short-term capital gains as long-term capital gains as in the U.S.A. in respect of their

operations are measures which need to be considered favourably in the larger interest of generation of liquidity in listed securities.

Offer to Non-Management Shareholders

To protect the interests of non-management shareholders, the Listing Agreement was specially amended in 1984 by incorporation of a new clause, viz. Clause 40, which requires anyone securing the effective control of management of a company or acquiring shares exceeding 25% of the voting capital of the company, to make an offer to the remaining members of the company to acquire their shares at a price not lower than the price at which the shares have been so acquired by them. This is, however, subject to the public shareholding not being reduced to less than 20% of the voting capital of the company so as to ensure that the shares of the company remain listed.

The above provision does not seem to have made any significant impact on the corporate world. Besides the problem of protecting the interests of non-management shareholders in the case of those limiting their acquisition to 24.9% of the voting capital of a company so as not to be attracted by the listing provisions needs also to be tackled.

Insider Trading

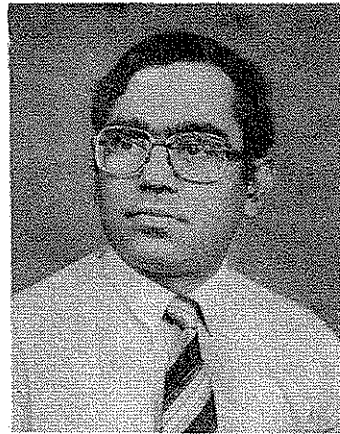
Insider trading i.e. trading in securities by persons in possession of material non-public information relating to such securities, which is price-sensitive, strangely remains totally uncontrolled and has proved to be one of the biggest menaces to the investors. The limited provision contained in Section 307 of the Companies Act requiring shareholdings and debentureholdings of directors to be recorded and kept open for inspection of any shareholder or debentureholder during the period of 14 days before and 3 days after the Annual General Meeting of a company has proved to be totally ineffective in controlling such trading. Publication of half-yearly results by listed companies as required by clause 41 of the Listing Agreement in operation from the beginning of last year has also not minimised such trading. Not only insider trading needs to be prohibited with provision for deterrent punishment for offenders under a suitable

statutory framework but also enforced strictly and rigidly. Till such time Government comes out with the legislation, it behoves stockbrokers as trustees of public welfare not to put in transactions of "insiders" if they realise that these are based on non-public information.

Conclusion

Success of the multifarious measures that may be evolved, all with laudable objective, s to control and regulate the market and to protect the interests of the investors ultimately lie on three things. First, the issuers of securities must be fair and honest in the management of the affairs for which the securities have been issued. According to a recent study about industrial sickness, deficiency in managements accounted for 52% of the large affected units, other reasons being market recession and enviornmental factors, technical factors and faulty planning, infrastructural factors, labour troubles etc. and as much as Rs.3,287 crores were sunk in 714 large sick industrial units as on the 31st December, 1986, not to speak of another Rs.1,588 corres in 1.47 lakh small and medium - scale sick units. Secondly, the stockbrokers who act as the intermediaries between the issuers and receivers of securities initially and as the intermediaries among the receivers themselves subsequently must also be fair and honest in their dealings. No matter howsoever honestly the stock brokers behave and howsoever dishonestly the investors act, for all the stockbrokers are not sinners nor all the investors are saints, there is a general feeling that investors are invariably taken for a ride by the stockbrokers. This feeling has slowly to give way to one of mutual trust which needs hard and assiduous labour on the part of the stockbrokers. Finally, administration of the Stock Exchanges has to be not only competent but also totally honest and tough, not being subject to pressures from any quarters, howsoever, powerful they be. If all these three factors are satisfied, atleast to a considerable extent, if not fully, we can achieve the goal of rising levels of savings moving into industrial securities and the population of holders of industrial securities continuously increasing. Before we march into the 21st century, let us have an India of atleast 50 million shareholders, accounting for about 5% of the population and Rs.1,00,000 crores as market capitalisation amounting to about 25% of the gross domestic product.

Mr. Ram Piparaiya



Mr. Ram Piparaiya

Mr. Piparaiya is an M. B. A. from the New York University Graduate School of Business Administration where he studied under Prof. Peter Drucker, the world famous management consultant. His professional career started with some of the USA's leading companies, and on his return to India was furthered by association with leading Indian Companies. In 1984 he set up Aridhi Investment Consultants Pvt. Ltd. He is also a member of the Bombay Stock Exchange. On the basis of his experience and knowledge, he has authored three books on investments, 'The Money Game', 'The Corporate Numbers Game' and 'Bulls, Bears and Blue Chips'.

SECURITY ANALYSIS
&
PORTFOLIO MANAGEMENT
ABSTRACTS FROM ADDRESS
TO BE DELIVERED BY
RAM K. PIPARAIYA

INDIA : NEW TRENDS

- * Centre-stage for Middle Class of 100 million.
- * Rural affluence from agriculture.
- * Growth of Small Enterprises.
- * Emergence of new class of entrepreneurs.
- * Corporate realignments.
- * Public concern over inefficiency/corruption.

ASIAN STOCK MARKETS : A COMPARISON

	M Market Capitalisation US billion	No. of Quoted stocks	Average P/E ratio
Japan	1315.0	1852	47.5
Hong Kong	34.5	240	16.6
Singapore	10.5	316	33.6
Malaysia	16.4	282	28.7
India	14.6	5000	9.0
Taiwan	12.0	127	18.0
Korea	7.4	342	8.4
Thailand	1.9	95	8.1
Philippines	1.4	202	12.1

Source: Vickers da Costa

Note: All figures relate to 1985

FUNDAMENTAL ANALYSIS

THREE SIMPLE FACTS TO SEEK ABOUT A COMPANY

1. What it pays to its shareholders?
2. What it earns?
3. What it owes and owns?

FACTORS INFLUENCING SHARE PRICES

AND THEIR APPROX. WEIGHTAGE

Market Sentiment	:	50%
Industry Related Factors	:	30%
Company Related Factors	:	20%

WHAT IS A REASONABLE P/E RATIO?

- * Fixed Income security (Zero-Growth) paying 12.5% p.a. is equivalent to a P/E ratio of 12.
- * Higher the expectation of growth, higher the P/E ratio.

DIVIDENDS : HOW THEY INFLUENCE SHARE PRICES?

% Increase in Price = 3 x % Increase in Dividend (including Dividend on Bonus Shares)

P/E Ratio = Price/Earnings Per Share

Don't be misled by a computation based on today's price and yesteryear's earnings.

STOCK SELECTION CRITERION

- * Performance
- * Prospects
- * Popularity
- * Pay-out
- * Integrity
- * Floating Stock

JUDGEMENTAL FACTORS IN STOCK SELECTION

1. Market Leadership
2. Industry Prospects
3. Corporate Plans
4. Environmental sensitivities
5. Ownership pattern
6. Probable developments not widely expected

TWO IMPORTANT CONCEPTS

1. **Group Tendency:** Shares with a common attribute constituting group move together, closely following a leader.
2. **Diversification:** Negative co-variance is more important than
bers, e.g. Beach Resorts and Umbrella Manufacturers.

CORPORATE NUMBERS GAME

Faces tell more than figures.

"The Number's Game"

Sales

- * Growth in value vs. volume?
- * Trend in unit realization
- * Purchases for resale
- * Trend in debtors/sales ratio

Assets

- * Revaluation Reserves
- * Capital W-I-P
- * Investments : Units, Bonds, Intercorporate

Profits

- * Depreciation
- * Tax Provisions
- * Write-backs
- * Capitalized Items
- * Liabilities not provided for, under 'Legal Advice'.

GROWTH

Are the following growing at about the same rate?

1. Assets
2. Sales
3. Profits

Dissonance signals disaster

HOW MUCH TO PAY FOR GROWTH?

Aridhi's Thumb Rule

Justifiable P/E Ratio = $6.5 + 2 \times \text{Expected Growth in EPS.}$

GROWTH STOCKS ARE BARGAINS

AT

MARKET COLLAPSES.

EXPANSION

Around expansions lead to surplus capacity.

What advantages will the company have over its competitors?

A USEFUL YARDSTICK OF COMPETITIVE STRENGTH :

DEBTORS / SALES

DIVERSIFICATION

Diversification in unrelated businesses has never been an instant success. How long will the company take to ride over the learning curve?

TYPES OF SHARES

- Pipe dream shares - Turnaround situations
- Bandwagon shares - Mass appeal
- One-decision shares - Consistent performers
- Blind-date shares - "Impulse", "Hunch" or "Tip" based.
- In-out shares - Fundamentals irrelevant. Good technical position.
- Index shares - Diversified group representing market average.

ANALYSING A NEW ISSUE

- * Promoters' Credibility
- * Promoters' Stake
- * Gestation period
- * Industry prospects - not now, but years later.

SHARE PRICE INDICES

1. What shares are included?
2. How are they weighted?
3. How are values calculated?
4. What is the base period?

ARIDHI INDEX

- * **Based Period** : January 1985
- * **Compositions** : 16 most speculative scrips which set the trend.

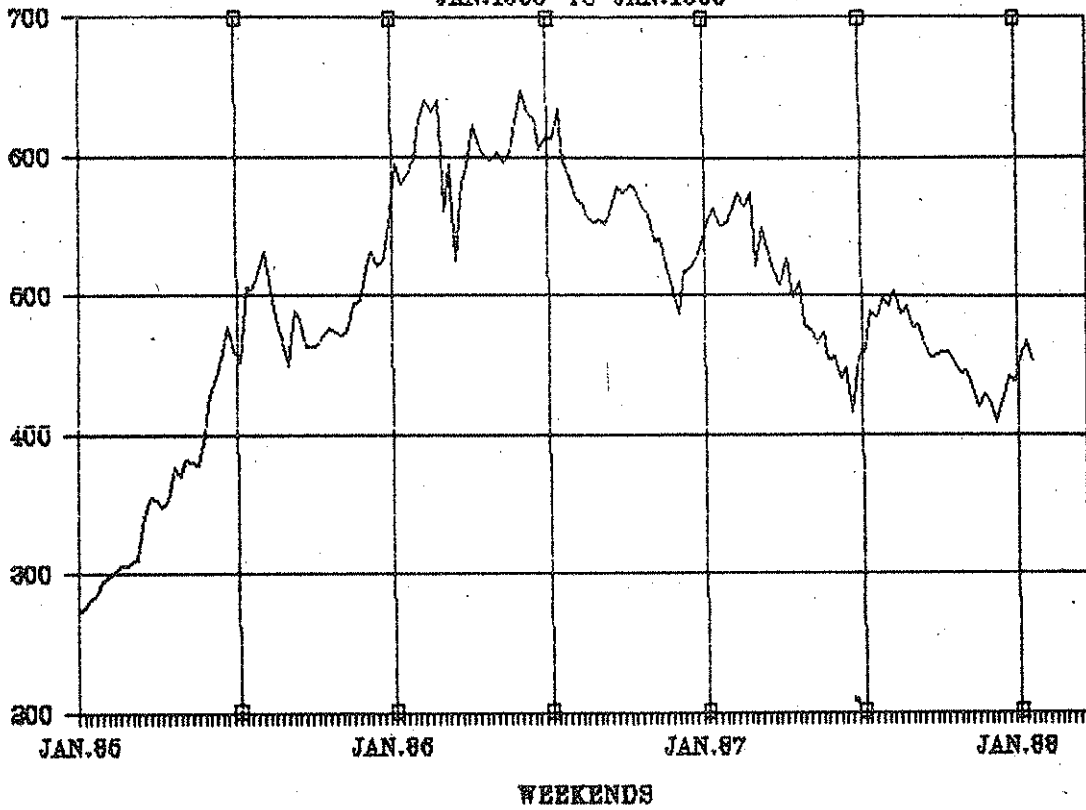
LIKE DOW JONES, ARIDHI INDEX

MEASURES THE TREND OF MARKET LEADERS ONLY.

THIS ADDS TO ITS FORECASTING VALUE.

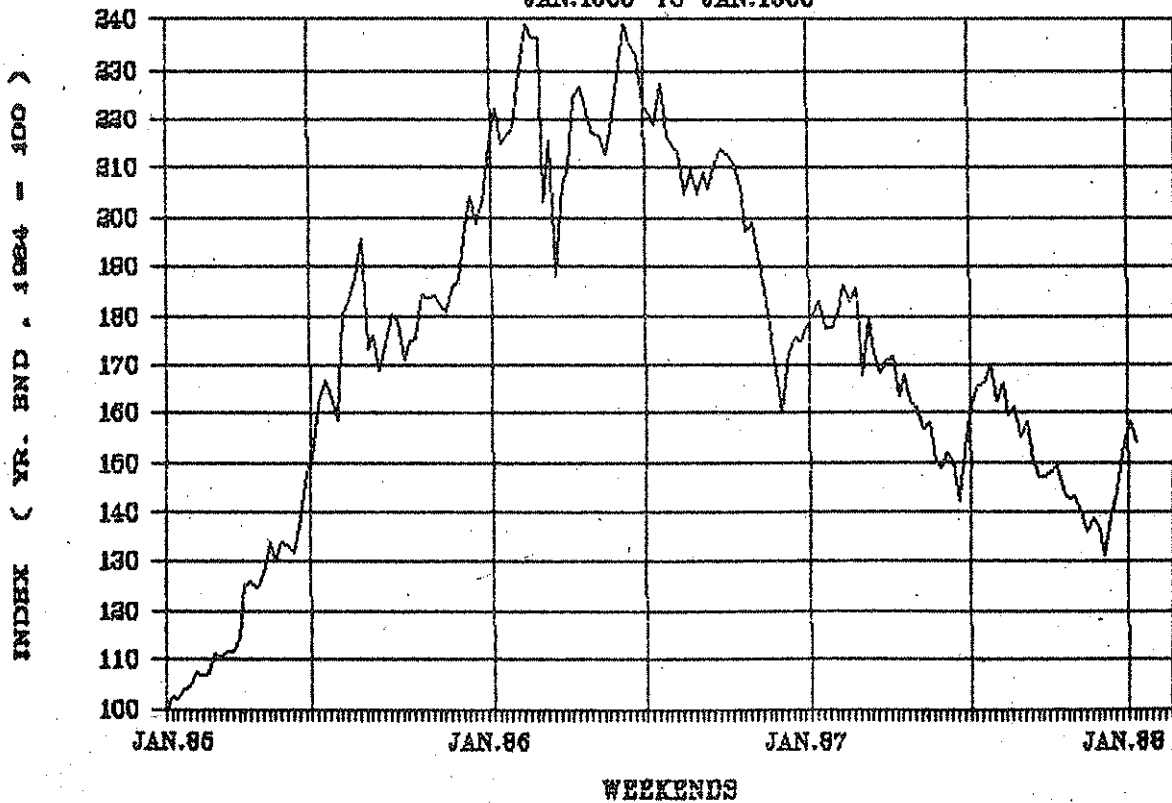
BOMBAY STOCK EXCHANGE INDEX

JAN. 1985 TO JAN. 1988



ARIDHI INDEX

JAN. 1985 TO JAN. 1988



FOUR AIMS OF PORTFOLIO INVESTMENT

1. APPRECIATION
2. INCOME
3. MARKETABILITY
4. SECURITY

**NO SINGLE SECURITY CAN COMBINE ALL THE FOUR.
HENCE THE NEED TO DIVERSIFY.**

TWO TYPES OF RISK

- Market related - Cannot be reduced by diversification.
- Company related - Can be reduced by diversification.

DIVERSIFY, BUT WITHIN LIMITS

Number of shares in a portfolio	Percent of risk elimination
2	46
4	72
8	81
16	93
32	96
64	98
500	99
All shares	100

FIXED HUMBERED PORTFOLIO -

SAY 20 MAXIMUM

Each time one is purchased,

another one should be sold.

PARADOX OF MONEY

GOOD EARNERS ARE BAD INVESTORS

Reasons

1. Lack of time.
2. Lack of inclination/exspertise.

*When a person with money meets a person with experience,
the one with money gets the experience,
and the one with experience gets the money.*

CAN MANAGEMENT

OF MONEY BE DELEGATED?

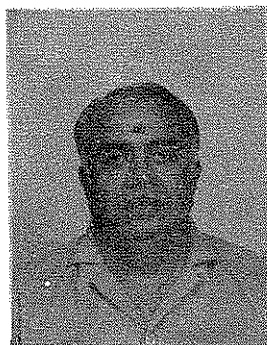
YES, provided you ensure:

1. COMPATIBLE and COMPETENT
money managers and/or consultants.
2. EFFECTIVE controls.
3. PERIODIC Reviews.

SUCCESS FORMULAE

*No formula will work on all occasions,
but some formula will always work.*

Mr. P. G. Ruiya



Mr. P. G. Ruia

He is a Commerce graduate and connected with the Stock Exchange since 1954. He has been on the Board of Directors of the Stock Exchange, Bombay for a considerable length of time and has won the respect of all who have come in contact with him. He is also a very active social worker and has been closely associated with several charitable trusts and Chambers of Commerce.

"FREE TRADING IN

SPECIFIED SHARES

WITH

SPECIAL REFERENCE TO LIQUIDITY"

By

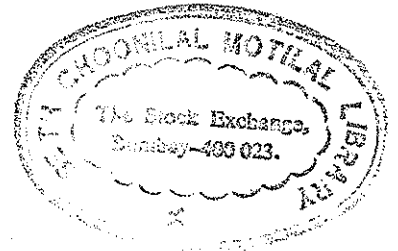
P. G. Ruiya

Director

The stock Exchange, Bombay.

It is indeed my great pleasure to talk to you on this occasion about "Free trading in specified shares with special reference to liquidity". I feel that in a democratic country where competitive price has always been the essence of any commodity or trade, it should be always free trade without any curbs or restrictions. It should be a free market, whether it is shares or any other commodity. This is particularly so for the stock market because it is said to be and looked upon as the 'barometer' of the economy of any country, adjudged on the basis of its growth, particularly the industrial segment of the economics.

I have made a reference to this because profit is the essence of any operation. It is a different question that ultimately at the end it may result in a loss but profit and loss are the two sides of the same coin which one has to accept. We, in the Stock Exchange, experience the same almost everyday whether we deal in specified, or 'A Group' shares, or non-specifieds, or 'B Group' shares. Call it by whatever name you like but ultimately it is a question of dealing in shares. Some of the most volatile shares have been grouped as active shares i.e., 'A Group' or specified shares



for trading as well as settlement purpose.

The shares grouped as specified shares are having a wide capital structure, high volatility and sharp sensitiveness as there are heavy stakes involved of different persons in the purchase or sale of such shares. At the same time one can easily get in or get out of his commitments in these shares by either booking profit or loss at any point of time and within a narrow range of price fluctuations. The shares traded as specified shares have almost all the liquidity which is required at any given time. A purchaser of any quantity of shares of any of the companies grouped as specified shares can always get the said shares on the date of settlement, if he is already with cash. This is only possible in specified shares and the most important part of it is 'free trading'. If there are restrictions on the trading pattern in these shares, which are imposed to given protection to anyone either big or small it would create artificial scarcity by imposing restrictions on the supply of the shares and realisation of money affects the liquidity of shares.

Sometimes even if a seller has no stock with him but if the buyer insists on any quantity of shares out of the quantity purchased by him, the seller has either to pay backwardation charges or has got to arrange the sold quantity of shares or any other less quantity of such sold shares for which the purchaser insists on taking delivery. If the seller fails to deliver the sold quantity of shares to the purchaser on the date of the settlement, it is automatically auctioned as per the Rules, Bye-laws and Regulations of the Stock Exchange at the cost of the seller and the purchaser is given full deliveries of all the shares bought by him without fail. This is particularly so in specified shares. Similarly if a seller has sold certain quantity of shares and would like to deliver the sold quantity of the shares, a purchaser has no other choice but to arrange finance for taking delivery of the shares which the seller insists on delivery and this is how a badla financier comes into the picture as a very essential and crucial role player in the smooth functioning of the Stock Exchange or any other commodity market for that matter of fact and the speculator buyer has to pay the contango charges. Badla financier is the buffer between demand and supply and brings the equilibrium in the market. Without a badla financier no forward market in shares can function.

Bold and timely administrative decisions at appropriate junctures in a given

circumstance or at the spur of the moment is of very significant importance and sometimes the indecisiveness in respect of removing the ban on free trading and restrictions such as prohibiting the delivery of shares by an investor even when he has the option of receiving backwardation charges or when the holder of the scrip has not to pay any badla charges (i.e. we call 'Bhav-Bhav Badla') or at times when very low badla charges are payable by the holder and who is willing to deliver his shares as a hedge transaction and realise his amount for the period till such profit or remuneration is available to him is detrimental to the free market trading. This affects adversely the liquidity of the scrip and an artificial scarcity is created. Hedge transactions are a very essential part of the operation of a free forward market but is generally not a widely recognised method of trading although it is in operation and in practice from the date of inception of forward trading. This is available only if there is a forward market or trading in specified shares which operation ensures to the investors, whether a purchaser or a seller, a buy back and/or a give back assurance of his quantity of shares after payment or receipt of an agreed sum and at an agreed price or at a price in which the backwardation or contango charges are included and which in turn maintains the fluidity and liquidity of shares in the market. This kind of insurance or security is not available in any other kind of trading other than trading in a forward market. As I have said earlier, profit or loss is the essence of all trading. The backwardation charges or low rate of badla in some scrips is essentially a factor which attracts an investor holder of that scrip to deliver the said scrip to the person who requires the same for delivery and makes him the payment which the investor holder can again very well reinvest for the same period and take delivery of some other scrip where higher badla rates (profit) are available and thereby help balance the liquidity aspect in trading in specified shares. A very important point to be noted in forward trading free market is the buy and/or the sale position of an operator.

Investments change hands frequently and therefore the operations in the market are always very frequent, big and enormous. Experience has shown that even the institutions are no exception to this phenomenon although they always try to boast of their huge purchases and sales but according to me they are also at par with any other operator in the market when it comes down to a question of making a profit or loss out of a deal and they also behave in the same fashion as an individual with enormous resources and/or the shares would have behaved. The liquidity would

always be available only in a free market in specified shares. The liquidity is much more because it is free trading in which options are available to buy back and/or give back at agreed price and agreed date. There is no compulsion or restriction of any nature and the investor whether a seller or a purchaser is always at a liberty to ask for or deliver his purchase or sell shares in the market on a fixed date at a fixed price backed by the badla financiers who act as a buffer in the operation of the Stock Market.

Option trading in shares is permitted in U.S.A. and other western countries. It is, however, banned in India. No one is clear about the reasons for banning such trading in this country. Options by their very nature provide hedging facility to operators in the market. Besides reducing the possibility of crisis in the market, this broadens the base of a market and makes for greater liquidity. In view of this, the ban on option trading in shares should be removed forthwith and the market be free from this constraint.

I would like to draw attention of the Exchange authorities to another area where improvement can and should be made. We in Bombay have nearly 400 active brokers daily doing business in the market. They vastly differ in their individual capacity to bear market risk. To group them all, big and small brokers together and subject them all, big and small brokers, together and subject them to some kind of restrictions such as limit on trading etc. is not proper and unduly narrows down the marketing possibilities. It is possible to ascertain the financial capacity of each of the brokers and classify them into different groups and allow each group to do business according to its capacity keeping in view the overall safety of the market. Alternatively margin and other measures say a graded margin system be so devised as to accommodate each of these groups in the trading pattern, so that there always remains a check on the over all working of all the brokers according to their financial capacities. This pattern may be followed all over India by respective Stock Exchange authorities and thereby allow the broker community to grow and stand by the need of the time and do required justice to the investing public.

All this is not available in non-specified or 'B Group' share and sometimes a seller investor is put to a very embarrassing position which may cost him big losses in

terms of money even if he is in possession of the sold quantity of shares but cannot deliver the shares on a specified date due to reasons beyond his control or due to some technical reasons of say outdated transfer, deletion of the names of one of the joint holders on account of death, delay caused by companies in sending back the shares sent to them for transfer, etc. It may be possible that some other investors might be holding similar quantity of such shares but as the badla sessions are not in practice in such shares either of them would not come to know as to what is the requirement of the other broker but the seller investor may be put to a heavy loss because of auction having already taken place.

I, therefore, have to conclude that free trading in specified shares can alone bring liquidity in the market and artificial restrictions and/or unwarranted interference in free trading aspects of forward trading or trading in specified shares would only create imbalance and hamper the growth of the equity cult in particular and the national economy in general and therefore should be avoided. This does not mean that checks and balances should not be exercised for controlled, constructive and healthy growth of stock markets in India.

Mr. SHIRISH DAVE



Mr. SHIRISH DAVE.

He is in business since 1958, and is a Member of The B S E Governing Board from 1980-81 to 1986-87. He is also a Member of Managing committee of Bombay Shareholders Association. His interests are Politics , Sports and Reading.

PERCEPTIONS
OF
A STOCK BROKER

BY

Mr. Shirish Dave.

1) BETTER CUSTOMER SERVICE:

(a) Need to plan and develop infrastructural facilities to cope within creasing volume of work.

Space - Bigger Working Capital : Training personnel and devel
oping skill - Computer systems - Communication systems.

(b) Efficiency of dependent services such as Banking - Corporate
sectors - Share transfer and Registration service - Telecommunication -
Post and Carriage.

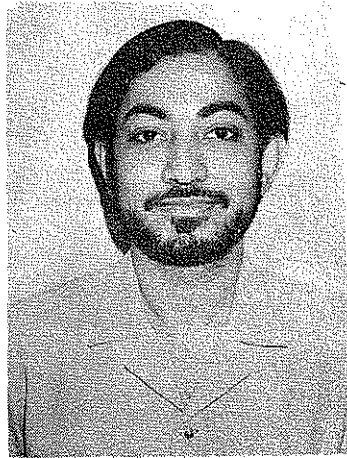
(c) Large volume of paper work involved in secondary market slackens
ef ficiency and speed.

- 2) SOME THOUGHTS ON FORWARD TRADING
AND MANAGEMENT OF DEFAULTS

- 3) RELEVANCE OF PRINCIPLE OF MINIMUM GOVERNMENT
AND CODE OF CONDUCT IN RELATION TO OUR PROFESSION

- 4) ENLISTING NEW MEMBERS - CORPORATE BODIES

Mr. Vallabh Bhansali



Mr. Vallabh Bhansali

He is a LLB cum Chartered Accountant. He started his carrier as Lecturer with Lala Lajpatrai College of Commerce and Economics. Today he is a director with Enam Financial Consultants Pvt. Ltd. and also on the board of several other companies. He has written a book titled 'Assertiveness Training Manual' as well as articles in various magazines. He is today an acknowledged expert in the field of Investments and Merchant Banking.

NOT ONLY INVESTOR EDUCATION

VALLABH BHANSHALI

DIRECTOR

Enam Financial Cons.Pvt. Ltd. Bombay.

CAPITAL MARKET - PROBLEMS & PROSPECTS'

I. PERSPECTIVE

- Several Agencies But no investment development agency
- all regulating agencies.

- Development left to private agencies
- good and bad.

Result

- (i) High cost of capital raising
- (ii) Several promoters happy to raise capital even at such high costs.
- (iii) Secondary market evils :
Unbridled speculation
Insider Trading, etc.
- (iv) Poor growth in investor population.

II. 'WHAT' OF EDUCATION EASIER

THAN 'HOW' OF EDUCATION

A blueprint emerges as an answer to the question -

'What does a wise investor know' -

He knows :

Good value

*Good temperament is more important than
good knowledge,*

Investment in shares is risky

Whom to trust

You make a profit only when you sell.

One who is willing to be fooled will be fooled.

Broker is not necessarily an expert on company prospects.

III. FIRST STEPS TAKEN

i) Credit Rating Agency Started.
BUT discussion is required as to what is to be done until it becomes fully operational.

ii) National Security Board

WHETHER it will end up as one more regulating agency or it will also play a positive/developmental role.

IV. STRENGTHEN THE INVESTOR.

Campaigns by Stock Exchanges :

- i) Rigorous action against defaulting companies/brokers.
- ii) Let there be a forward market.
- iii) Create Perpetual Listing Norms.
- iv) Newspaper adverts about investor rights - Refunds, Dividends, A.G.M's., Balance Sheets.
- v) File Prospectus fraud suits.

Funds to be provided by Companies/Brokers/Investors/Government through cess or grant.

V. MORE STEPS

Using Television - for education and ongoing critical appraisal

Setting up a National Institute for investor education.

**VI. WITH HUMILITY ADDRESSING OTHERS - PRESS, BROKERS,
STOCK EXCHANGES,
INSTITUTIONS, GOVERNMENT**

- 1) - Which 'authoritative reports' and 'marketmen beliefs' are printworthy.
 - If some company reports can be analysed thoroughly - why not more.
 - Why the reporting of the AGM proceedings is limited/stereotyped.
 - Financial reporters - How qualified.
- 2) - Does a chemist prescribe medicines - discuss the analogy as applied to brokers.

Does a broker tell his clients what he really knows - technical position, pari passu fraud and what that price difference indicates, etc.,

- 3) - Why regulating agencies take on 'directive' roles - do they know the consequences and the extreme compromise of their independence involved in it.
- 4) - Should the institutional market operations not become more intellegible to the investors at large - what an example it can become for the whole investor community !

Can an investment that is not good for an individual investor be good enough for institutions or vice versa?

Is it healthy to assure returns?

- 5) - Is mobilising resources from the unwary desirable?
 - 1985 mobilisation - Is it that we want its dream part without its ugliness?
 - What comes first - regulated well developed market or resource mobilisation?
- 6) - Is the popular financing pattern of projects devouring our capital.
- 7) - Are our investment parameters obsolete.

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