INDIAN STOCK MARKETS

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INTRODUCTION

The Indian stock markets are today on the move. The air of openness and the policies of liberalisation pursued by the new Indian Government have aroused keen interest among the investors, both within the country and outside. The changes taking place in the Indian economy and the Indian capital markets in the last four months have been so profound in character that it is rather difficult to visualise any comparable development in any other part of the world. The recent massive structural trade and industrial policy reforms, the two succeeding devaluations of the Indian Rupee, the delicensing of all but a few core sectors and the Government announcements on the impending full convertibility of the Indian Rupee, freedom for Indian companies to enter foreign capital markets and the Government's will to totally deregulate the Indian economy have spurred the activities in the stock markets. As a result not only have the markets witnessed a quantum jump in activities due to the profound changes but more importantly the very characteristics of the Indian stock markets have undergone a metamorphosis to emerge as a major entity in the Indian financial system.

Investment in India is subject to certain laws which have recently been modified and liberalised. The limit for foreign investment in Indian companies has been
increased to 51% of the total equity. This was further increased to 100% in certain specified industries. Various investment opportunities are available and the recently introduced India Development Bonds (IDBs) scheme, covered under Investment opportunities for overseas investors, is a very attractive one.

India is poised for a takeoff and the resounding changes made recently are expected to give it the much needed boost to cover her balance of payments problem and the imbalances in her foreign trade. Indeed the stage is now set for India to make her presence felt abroad as one of the fastest growing economies not only in Asia but all over the world.

**INDIAN ECONOMY**

The Indian economy is no longer a stagnant economy. It has already transformed itself into a fast growing economy with the average annual growth rate during the decade of 80s being of the order of 5.5 per cent as against the almost stagnant average growth rate of 3.5 per cent witnessed in the earlier three decades. Equally significant is the savings ratio in the economy. Gross domestic savings as a percentage of gross domestic product zoomed more or less progressively from a low level of 10.2 per cent in 1950-51 to 23.2 per cent in 1978-79 before settling down to around 20 per cent thereafter. India is thus blessed with a growing pool of savings,
currently of the order of about one trillion rupees i.e., about $56 billion. Indian industry too has been growing at a substantial rate of about 8 per cent in the 80s as against about 5 per cent in the earlier decades. The agricultural sector, which dominated the economy for a long-time, no more does so. The overall dominance of the primary sector comprising agriculture and mining has come down while secondary and tertiary sectors are having a greater share of the economic activity. India is today among the ten largest industrialised nations in the world with the third largest reservoir of scientists and technologists and the growth process is likely to accelerate in the current decade particularly because of the several measures taken by the Government to liberalise the economy.

**GROWTH OF STOCK EXCHANGES**

India has the oldest stock exchanges of Asia. Nearly 200 years ago, trading in securities used to take place although the first stock exchange came to be established in 1875 in Bombay. The process of establishment of stock exchanges gradually spread to other cities of the country like Ahmedabad, Calcutta, Madras, etc. As a result, in the initial years of regulation of the Securities Contracts (Regulation) Act, 1956 - the first all India legislation regulating the stock exchanges in the country - there were eight recognised stock exchanges in the country. For nearly two decades thereafter, the number virtually
remained unchanged. The decade of eighties, however, saw the birth of a number of new recognised stock exchanges in the country and there are at present 21 recognised stock exchanges spread as far as Ludhiana in the North, Cochin in the South, Gauhati in the East and Rajkot in the West. With the cult of equity spreading fast to the four corners of the country, prospects of many more stock exchanges springing up in the country are bright and there could easily be over 40 stock exchanges humming with activity all over the country by the end of the century. Relatively poor communication facilities in the country and the imperative need for a direct and close regulating authority easily accessible to the investors are the *raison-d'être* for proliferation of stock exchanges.

**BURGEONING STOCK MARKETS**

The Indian stock markets have grown so sharply in the 80s that the decade itself has been christened, inter alia, the decade of the capital market. The extent of growth can easily be measured by the fact that as against an annual average amount of just Rs.900 million raised from the new issues market in the seventies, Rs.61.5 billion was raised during 1989-90 although during the next year i.e., 1990-91, there was a dip to about Rs.50 billion. The number of listed companies rose over the decade from about 2,200 to about 6,000 catapulting this nation to the position of being next only to the United States of America, which had 6,727
listed domestic companies, and having thrice the number of domestic listed companies of a little over 2,000 each of United Kingdom and Japan, at the end of 1989. The daily turnover in Indian stock markets has shot up from about Rs.150 million in 1979-80 to about Rs.3 billion in 1990-91. The number of shareholders has also risen sharply from about 2 million to over 10 million during this period, catapulting this nation to the position of being the second largest shareholding population nation in the world, next only to the United States of America. Market capitalisation has also shot up from about Rs.35 billion to over Rs.1 trillion during the last one decade, accounting for about 20 per cent of the GNP now as against about 5 per cent ten years ago.

The unprecedented growth of the Indian stock markets has resulted in these markets becoming a major market in the emerging stock markets of the world, next only to Taiwan and Korea, both in respect of market capitalisation and turnover. In terms of U.S. dollars, the market capitalisation of the Indian stock market at the end of September, 1990 was about $ 50 billion as compared to $ 65.0 billion of Taiwan and $ 93.9 billion of Korea while the daily volume of turnover in the Indian stock markets during the quarter ended September, 1990 was about $ 130 million as compared to $ 2,834.79 million of Taiwan and $ 233.53 million of Korea.
INDIAN STOCK EXCHANGES

GOVERNING BOARDS OF STOCK EXCHANGES

In tune with the developments the world over, complexion of the governing boards of Indian stock exchanges too is undergoing a change, with more of non-broker directors being inducted into the board rooms of the stock exchanges. Presently, non-broker directors who are generally representatives of the Ministry of Finance, Department of Company Affairs, Financial Institutions and Securities and Exchange Board of India - the newly formed watch-dog of the securities industry - and some leading personalities drawn from different professions like chartered accountancy, law, etc., constitute about one-third of the strength of these boards. It is the intention of Government to raise the strength of non-broker directors to about one-half of the size of the boards, as is normally the pattern in some of the developed markets of the world.

What is particularly significant is that the non-broker directors are nominated either directly by Government or with their approval which doubly ensures that they always act in the public interest. Even the presidents and vice-presidents at most of the stock exchanges are also nominated by Government from among the elected stockbroker directors.
Day-to-day administration of stock exchanges is entrusted to executive directors, at several of the stock exchanges, appointed with the approval of Government. There is a move to appoint executive directors at all the stock exchanges so that the day-to-day administration is not looked after by elected stockbroker presidents.

There are a number of sub-committees other than the arbitration and defaulter committees at all the stock exchanges which continuously attend to the work of improvement of the market and betterment of services rendered by stock exchanges.

Membership of Stock Exchanges

With the increase in the number of stock exchanges, the number of active stockbrokers has also increased during the last one decade. There are today over 3,000 active stockbrokers all over the country as against about 1,250 about ten years ago. Stockbrokers are also encouraged to amalgamate themselves into corporate entities for which the statute was specially amended in July, 1987.

The amendment to the statute effected by Government in July, 1987 also provides for admission of Financial Institutions and their subsidiaries and subsidiaries of banks in the public sector to be admitted as members of stock exchanges on their being so recommended by the
Government of India. It is pertinent to observe in this connection that this does not mean that the country has accepted the concept of "universal banking" as is the practice today in most of the European countries, as stockbroking firms would continue to be barred from entering the field of commercial banking.

With a view to developing a national market system in the country, the statute has also been amended permitting multiple membership of stock exchanges. Quite a few broking houses are now engaged in getting themselves enrolled as multiple members.

**Turnover**

The Bombay Stock Exchange which accounts for more than two thirds of the total turnover in securities all over India has on an average about 70,000 deals executed during the two hour trading session, which makes it one of the highest per hour intensity of trade in the world.

During the year 1990-91 (April-March), 3,377.40 million shares worth Rs.360.12 billion were traded on the Exchange. The turnover was 22.5 per cent higher by value as compared to the turnover of 2,784.80 million shares worth Rs.293.86 billion recorded during the previous year (April 1989-March 1990). The average daily turnover during the year 1990-91 was Rs.1,756.70 million and on several days, especially during the second quarter
of the year, the average daily turnover exceeded Rs.2,500
million. By comparison, the average daily turnover during
1989-90 was Rs.1,354.20 million.

**Market Capitalisation**

The spectacular rise witnessed in the share prices in
1990 despite the fall in the last quarter and in January, 1991
led to a steep rise in percentage of market capitalisation to
the gross national product of the country. The estimated
market capitalisation of about Rs.825 billion as on March
31, 1991 amounted to as much as 18.1 per cent of the gross
national product of the country as against a meagre 5.1 per
cent as on March 31, 1980. The percentage of 18.1 is quite
comparable with the average of European countries of 25
per cent although well below the percentage of U.S.A.,
U.K. and Japan of over 75 per cent.

**Primary Market**

The decade of the 80s witnessed stock markets as a
major source of finance for industry and trade. Average
annual capital mobilisation from the primary market
which used to be about Rs. 700 million in the 60s and about
Rs.900 million in the 70s increased manifold during the 80s
with the amount raised in 1989-90 being of the order of
Rs.61.5 billion. The dip in 1990-91 to about Rs.50 billion is
only a passing phase and not less than Rs.100 billion per
year is expected to be raised by 1994-95, the final year of the Eighth Five Year Plan. Even the public sector undertakings are taking increasing recourse to the primary market through the issue of bonds. The amount raised by them increased from Rs.354 million in 1985-86 to Rs.3,579 million in 1990-91. Annexure I gives details of the capital raised from 1960-61 till 1990-91.

The vibrancy of the market can be better gauged by the fact that while only ten years ago, the total capital mobilisation in a year itself was about Rs.one billion, there were as many as eleven issues, each one of which raised more than Rs.one billion during 1989-90. In order to ensure that no undue advantage is taken by the receptiveness of the fast expanding market, Government has already issued guidelines in respect of all issues of Rs.500 million and above directing that (i) proceeds from the issues be used strictly for the requirements of the projects/activities mentioned in the application for approval and not for any other purpose, (ii) the proceeds to be invested only in fixed duration deposits/instruments with the co-operative/nationalised banks, Unit Trust of India, Financial Institutions and public sector undertakings till they are deployed in the proposed activities, (iii) monitoring of the use of funds by some Financial Institutions like the Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, etc., and, (iv) the amount to be called as 25 per cent on application, 25 per
cent on allotment and the remaining 50 per cent in two or more calls only after the monitoring institution is satisfied about the use of funds already collected.

The average size of capital floatation is also showing a significant increase. During 1989-90, the average size of the equity issue was Rs.52.7 million as against Rs.4.9 million in 1979-80. The average size of debenture issue also has similarly gone up to Rs.380 million during 1989-90 from Rs.7.0 million in 1979-80. This has happened because of reasons like companies under the present liberal conditions are being encouraged to go in for 'minimum economic size projects', capital intensity of the projects having increased, companies turning more and more to the stock market to mobilize their funds, etc.

Stock Market Instruments

The Indian stock markets have not yet been able to develop fully a large spectrum of instruments to meet the diverse requirements of the investing public. Equities continue to be the main stay of the market. However, in recent years, convertible debentures which are converted into equities either fully or partly are becoming more popular and during 1989-90 they accounted for about 73 per cent of the capital raised during the year. Non-convertible debentures, which, in the first half of 80's, were popular with the investors because of the progressive rise
in the rate of interest on these debentures from 10.5% in 1977 to 15% in March, 1985 but subsequently scaled down to 14%, are now invoking only lukewarm response from them. These are now being subscribed mostly by mutual funds, Financial Institutions, Army Pension Funds, etc. The Government has recently made credit rating compulsory for all debt instruments and removed restrictions on the rate of interest which can be paid on such instruments. However, this does not apply to instruments of public sector units enjoying tax exemptions.

Preference shares are virtually dead mainly because the rate of return from these shares, which are not backed by any security, is the same as from debentures. Cumulative Convertible Preference Shares - an instrument giving regular returns at 10 per cent during the gestation period from three years to five years and equity benefit thereafter - introduced by Government in 1984 has also failed to catch the investors' interest mainly because the rate of return was considered to be too low in the initial years and the provision for conversion into equity also unattractive if the company failed to perform well.

A few companies have recently tried new instruments, hitherto alien to the Indian stock markets, like warrants attached to non-convertible debentures, carrying the right to subscribe to or the option to convert them into equity shares at the end of a specified period, and zero-
interest convertible bonds offered at a discount where the loss of interest is compensated by a lower price. Warrants also have been recently attached to offers of equity shares. Although it cannot be stated that these instruments have become popular with the investors, they have been well received with all of them being oversubscribed.

OTC Exchange of India

With the requirements for listing the securities on a stock exchange being quite onerous, particularly in respect of issued capital of the company being not less than Rs.30 million out of which normally 60 per cent i.e., Rs.18 million being required to be offered to the public, a need has been felt for quite some time for a second-tier market in the country where companies with a lesser capital and with less onerous conditions could have the advantage of listing. With that end in view, OTC Exchange of India (OTCEI) promoted by the Unit Trust of India, Industrial Credit and Investment Corporation of India and others was granted recognition in August, 1989 by Government under the Securities Contracts (Regulation) Act. OTCEI would be a national, automated and ring-less stock market which will help particularly small companies and companies assisted by venture capitalists to raise finance from the capital market in a cost-effective manner and provide a convenient and efficient avenue of capital market investment for investors at large.
Every scrip listed on this market will have at least two market-makers who will continuously give two-way quotations. A company can get the benefit of listing by offering even 20 per cent of its issued capital to the public. OTCEI is expected to be operational shortly.

Credit Rating

Another significant development in the new issues market is the establishment of the Credit Rating and Information Services of India Ltd. (CRISIL) set up jointly by the Unit Trust of India, Industrial Credit and Investment Corporation of India Ltd., Life Insurance Corporation of India, General Insurance Corporation of India and the Asian Development Bank and a few other institutions. The primary objective of CRISIL, which started its operations in January, 1988, is to rate debt obligations of Indian companies, thereby providing a guide to investors as to the risk of timely payment of interest and principal on any particular debt instrument. These ratings relate to a particular debt instrument and are not a rating for the company as a whole. CRISIL assigns ratings after taking into account various key factors like industry risk, market position and operating efficiency of the company, track record of management, planning and control systems, accounting quality and financial flexibility, profitability and financial position of the company, apart from its
liquidity management and asset quality i.e., quality of company’s credit risk management.

As on March 31, 1991, the cumulative number and value of debt instruments rated by CRISIL were 176 and Rs. 43.57 billion.

In order to inject a competitive edge to the system, the Industrial Finance Corporation of India established on the 16th January, 1991 a second credit rating agency in the country called Investment Information and Credit Rating Agency of India (IICRA).

**Secondary Market**

The turnover in the Indian stock exchanges has increased significantly during the last ten years, particularly during the last three years. The Bombay Stock Exchange, accounts for about two-thirds of the business in the country.

What is remarkable about the Indian stock markets is the number of deals put through in a day. On an average, about 45,000 deals were executed in a day on the Bombay Stock Exchange alone in 1989-90 compared to about 85,000 deals on the New York Stock Exchange and about 45,000 deals on the International Stock Exchange of London. The boom period, June to October, 1990, often
saw the number of deals shoot to about 80,000 deals a day and taking into account the fact that trading is confined to only two hours in a day, the Bombay Stock Exchange registered the highest per hour velocity of transactions next perhaps only to Taipei.

**Trading Pattern**

Trading in Indian stocks is broadly categorised into two groups, viz., specified shares and non-specified securities. Equity shares of dividend paying, growth-oriented companies with a paid-up capital of at least Rs.50 million and a market capitalisation of at least Rs.100 million and having more than 20,000 shareholders are normally put in the specified group and the balance in the non-specified group. Stock exchanges located at Bombay, Calcutta, Delhi and Ahmedabad have at present this facility of a two-tier market with the rest of stock exchanges conducting trading only under the category of non-specified securities. Equity shares of 78, 58, 40 and 18 companies are classified as specified shares at the Bombay, Calcutta, Delhi and Ahmedabad stock exchanges respectively. With 68 shares being common among them, the number of companies whose equities are traded as specified shares is 126. They account for about 56 per cent of the market capitalisation of the Indian stock markets.

All trading is basically conducted as hand delivery
contracts, i.e., for delivery and payment within the time or on the date stipulated when entering into the contract which is not more than 14 days following the date of the contract. In the case of specified shares, however, delivery and payment can be extended by further periods of 14 days each so that the overall period does not exceed 90 days from the date of the contract. Contracts in specified shares can be closed during the settlement period by purchase or sale, as the case may be, or carried over to the next settlement period and only those contracts which remain outstanding have to be performed by delivery and payment. The system of trading in specified shares is thus an amalgam of cash and futures. The Indian stock markets do not yet have any separate segments for futures and options. In the case of non-specified securities, by and large, contracts are performed by payment and delivery.

Indian stock markets continue to operate in the age old conventional style of face-to-face trading with bids and offers being made by open outcry. At the Bombay Stock Exchange, there are about 3,000 persons milling around in the trading ring during the trading period of two hours from 12.00 noon to 2.00 p.m.

The stock exchanges at Bombay, Calcutta and Ahmedabad are basically quote-driven markets with the jobbers standing at specific locations in the trading ring called trading posts and announcing continuously the
two-way quotes for the scrips traded at the post. As there is no prohibition on a jobber acting as a broker and vice-versa, any member is free to do jobbing on any day. In fact, actual practice, however, a class of jobbers have emerged who generally confine their activities to jobbing only. As there are no serious regulations governing the activities of jobbers, the jobbing system is beset with a number of problems like wide spreads between bid and offer, particularly in thinly traded securities, lack of depth, total absence of jobbers in a large number of securities, etc. In highly volatile scrips, however, the spread is by far the narrowest in the world being just about - 0.1 to 0.25 per cent as compared to about 1.25 per cent in respect of alpha stocks i.e., the most highly liquid stocks, at the International Stock Exchange of London. The spreads widen as liquidity decreases being as much as 25 to 30 per cent or even more while the average spread of gamma stocks i.e., the least liquid stocks at the International Stock Exchange, London, is just about 6 to 7 per cent. This is basically because of the high velocity of transactions in the active scrips. The first five most volatile scrips on the Bombay Stock Exchange, viz., Associated Cement Co. Ltd., Bombay Dyeing and Manufacturing Co. Ltd., Baroda Rayon Corporation Ltd., Indrol Lubricants Ltd. and Apollo Tyres Ltd., had their equity capital traded 15.81, 5.63, 5.04, 4.57 and 3.63 times respectively during the year 1989-90. In fact, shares in the specified group account for over 75 per cent of trading in the Indian stock markets while over 25
per cent of the securities do not get traded at all in any year. Yet, it is significant to note that out of about 4,200 securities listed on the Bombay Stock Exchange, about 1,400 securities get traded on any given trading day.

The markets in the rest of the country are mainly order driven markets with the buyers and the sellers transacting directly with each other. Although this has the advantage of giving to the investors a better price, growth of business in these markets has been hampered with a relatively higher degree of volatility and illiquidity.

**Disclosures**

**On Going**

The listing agreement which a company is required to execute with the stock exchange before enlistment and the provisions in the Companies Act provide for detailed ongoing disclosure requirements by a listed company. As per the latter, companies are required to publish their annual unaudited accounts within a period of six months from the date of closure of the accounts. Companies are also required to give director's report along with audited accounts covering, inter-alia, the material changes and commitments, affecting the financial position of the company which has occurred between the end of the financial year to which the balance sheet relates and the
date of the report. The material changes which have occurred during the financial year in relation to the company's business or the class of business in which the company has an interest is also required to be disclosed. The listing agreement requires a company to furnish to the stock exchange and the press information about unaudited financial results on a half-yearly basis within two months of the expiry of the period, advance notices of its Board meetings to be held for declaration of dividend, right or bonus issues to be followed by the notification of the decisions taken at these meetings, cancellation/redemption of securities listed, proposals in the general character of any of its business, changes in the management, material events such as strikes, lock-outs, closure on account of power cuts, etc., both at the time of occurrence and subsequently after its cessation, etc., so that shareholders and the public are able to apprise constantly the position of the company and avoid establishment of a false market.

It is a matter of gratification that the stock exchanges of the country, particularly the Bombay Stock Exchange, are generally quite vigilant about the above on going disclosure requirements and have suspended trading in the securities of quite a few companies whenever companies were found lacking in compliance of these requirements.
New Issues

Any company inviting the public to subscribe to its securities or arranging for an offer for sale of its existing securities has to issue a prospectus or a letter of offer relating to the issue.

In order to enable the potential investors to take a well informed decision in the matter, Schedule II of the Companies Act, 1956 sets out the matter to be included in the prospectus/letter of offer. Many of the issue highlights, like 'latest or proven technology', 'assured market', 'low break-even point', 'assured dividend' that allure unwary investors unfortunately go unsubstantiated. The authorities are seized of the need to improve the contents of the prospectus/letter of offer. In the meantime, the duty cast on the merchant bankers to exercise due diligence independently verifying the contents of the prospectus/letter of offer and reasonableness of the views expressed therein and certify to that effect to the Securities and Exchange Board of India is expected to improve the system.

SETTLEMENT OF TRANSACTIONS

Settlement processes at the Indian stock markets are still matters of concern. At the Bombay Stock Exchange, settlement of transactions by way of delivery of securities
and payment of price virtually takes a fortnight or even longer both in respect of specified shares and non-specified securities. This is basically because of the system of batch processing of the transactions wherein the matching of the reported sales and purchases is inevitable. It is now proposed to have an on-line system of processing of transactions reported directly from the screen to be operative alongwith the automation of the trade. This will help to reduce the period required for settlement of transactions. In respect of non-specified securities, it is planned to reduce in the first instance the period of trading from 14 days to 5 days, Monday to Friday, with the settlement being effected the following week and later on move over to a rolling settlement system of T+5 i.e., the settlement being effected on the fifth trading day following the date of transaction, to be eventually replaced by T+3 as recommended by the global Group of Thirty. The question of extending the concept of T+3 to the specified group of shares, however, needs detailed consideration as such an extension would also need development of options and futures markets.

Share certificates and dated transfer deeds constitute a major hurdle in the growth of the securities business. A two-stage attack on the system is, therefore, planned. First is the immobilisation of the securities. A beginning has already been made with the establishment of Stock Holding Corporation of India which handles the shares of
financial institutions. The Bombay Stock Exchange has also, in association with Bank of India Ltd. - a leading nationalised bank of the country - which currently runs the Clearing House of the Exchange, established BOI Shareholding Ltd. This will initially act as a depository in respect of shares involved in carry-forward transactions in specified shares worth about Rs.5 billion with the shares moving by book-entries only. Later on, the services of the depository will be extended to other activities of stockbrokers and also of investors. The second stage is to develop a certificateless society as has already been done in Norway, Denmark and France and as is being planned in U.K. by the proposal to establish TAURUS. In fact, a proposal in this behalf was put forward by the Bombay Stock Exchange way back in 1979. Serious attempts are now being made to put this proposal into operation.

Proposed Trade Support System

With a view to imparting greater transparency to trading, and at the same time, reducing the cumbersome paperwork associated with the process of settling trades, the Bombay Stock Exchange has been considering the installation of a mainframe computer connected to terminals in the offices of members. With this network, it would be possible to establish a screen-based system of trading, and also to cater to the provision of accurate and timely market information and data, on a host of electronic
devices such as tickers, monitors, boards and computer terminals. It is also proposed to provide extremely useful value-added information through the network, to members and other public, on company profiles, new issue details and market statistics.

Initially it is proposed to introduce trading in all the non-specified stocks totally on the computer, taking care, however, to retain the basic characteristics of the market such as the system of jobbing. Order execution would, therefore, be totally screen-based for this group. The project is expected to commission immediately after the second phase of the new building is completed. Trading in specified shares would, however, be carried out through the open outcry system, as at present, during this period. Screen-based trading for these active stocks would be considered for implementation at a later stage, depending upon the success achieved and the experience gained from the system established for the non-specified stocks.

Information dissemination

The system would enable all members to have the latest information about ruling prices in the market, the highs and lows for the day, last trade details, cumulative volumes transacted and index values. In addition, it would also provide them with their cumulative positions for the settlement period under consideration. The
registered jobber, would in addition, also get complete
details about his net positions in each of the scrips that he
has handled, along with the current asking rates so as to
breakeven in the market.

Implementation

The system will be implemented in four phases as
detailed below: Phase I is expected to commence in the
first quarter of 1992. It provides for dissemination of two-
way quotes, company & Exchange announcements, indi-
cative transaction prices, etc. in respect of all specified
scrips and 200 active non-specified scrips on display
devices located in the new trading ring and at other
vantage points in the Exchange complex. Interfaces with
the PTI STOCKSCAN System would also need to be
established.

Phase II is expected to be operational in the second
quarter of 1992. It will establish a network connecting
individual member offices with the central Exchange
computer established for providing the following services:

- input of transactions and other data required
for the existing batch settlement system

- access/download of processed information
to each member to meet settlement require-
ments, and
online reconciliation facility for unmatched transactions.

Information captured in Phase I would be available to members through the network installed in Phase II. Members would also have a facility to draw upon the Stock Exchange Official Directory (SEOD) database.

Phase III to be introduced in the latter half of 1992 will provide for an automated trading system covering all scrips except those in the specified group and 300 of the most actively traded ones in the non-specified group would be implemented. The functionality proposed would cover quotation entry and maintenance, order entry/maintenance and execution, trade reporting, information dissemination and market surveillance.

Phase IV which is expected to be operational in the first half of 1993 will extend the coverage of the automated trading system to include even the most actively traded scrips in the specified group.

The Bombay Stock Exchange is not alone in its march towards computerisation. Most other stock exchanges have also started computerising the settlement system with a few of them even introducing the trading ticket system which gives near instant information about the trade details. The question of automating the trade
with on-line processing of transactions for settlement purposes with display of real time trade information will also be considered by all these stock exchanges in course of time.

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 25.1% during the period 1980 to 1989 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.

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 interests 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. The Stock Exchanges have on their own evolved a number of measures to alleviate the grievances of investors and to grant them progressively greater degree of protection.

A Customer's Protection Fund was set up at the Bombay Stock Exchange in October, 1986 on the lines of the Securities Investor Protection Corporation of the U.S.A. The fund is financed partly by way of a levy on the turnover of members collected at the rate of one rupee of every Rs. 1 million and partly by way of contribution from
the listing fees collected at the rate of two per cent. The Fund has Rs.2.27 million to its credit as at the year ended the 31st March, 1991. 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.15,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the Fund.

**PTI Stockscan Service**

The Sensitive Index of the Bombay Stock Exchange related to 30 scrips traded on it and the BSE National Index involving 100 scrips traded on all the five stock exchanges are continuously displayed on the PTI Stockscan Service with revisions being made every two minutes. The Stockscan Service, which presently gives, inter-alia, the movement of prices of about 800 shares, is available not only at these five stock exchanges but also at other stock exchange centres. The PTI Stockscan Service has rightly been called the forerunner of the National Market System in the country.

**Training Institute**

Training and development of human resources is one of the most important and critical responsibilities in
any country and more so in a developing country like India. Training is a continuing process in life and training plays a crucial role in the optimum utilisation of human resources. The Stock Exchange Bombay, set up the Stock Exchange Training Institute on the 3rd January, 1989 to train stockbrokers, jobbers, authorised clerks, merchant bankers, portfolio managers and investors in general. The Stock Exchange Training Institutes at Bombay and Calcutta are being increasingly recognised as premier institutes for training in stock markets.

**Securities and Exchange Board of India**

The burgeoning growth of the stock markets has inevitably resulted in the establishment of a separate watch-dog for the securities industry. Accordingly, the Securities and Exchange Board of India, decision about the establishment of which was made by the Prime Minister while presenting the Budget for 1987-88, was constituted on April 12, 1988. The Board, to begin with, has been asked to (i) deal with all matters relating to the development and regulation of securities markets, and investor protection, and advise Government on these matters, (ii) prepare comprehensive legislation for the regulation and development of securities markets, and (iii) carry out such functions as may be delegated by Government for the development and regulation of securities markets. The comprehensive piece of legislation prepared by the Board for regulation
and development of securities markets is under the active consideration of Government. The health of the securities market is bound to be toned up with the direct involvement of the Board with their regulation and development.

The Board has also issued guidelines and a code of conduct for merchant bankers. In addition merchant bankers are required to be authorised by the Board. At the end of February, 1991 there were in all 73 merchant bankers authorised by the Securities and Exchange Board of India.

The Securities and Exchange Board of India has also introduced a system of imposing penalty points to merchant bankers who violate the terms of their authorisation. For this purpose, the areas of non-compliance/default have been divided into four types, viz., (i) general defaults, (ii) minor defaults, (iii) major defaults, and (iv) serious defaults and the penalty points for these four types are one, two, three and four respectively. A merchant banker on reaching a total of eight penalty points shall attract action from the Securities and Exchange Board of India which may include suspension/cancellation of authorisation. The above measures were introduced to inject a sense of accountability and responsibility into the business of merchant banking.
FUTURE PLANS

Premises

With the completion of the second phase of the Stock Exchange building, a new trading ring admeasuring about 19,000 sq. ft. will be ready for use by January, 1992. The new ring, apart from being more spacious than the existing trading ring, has several state-of-the-art features which will make it comparable to the best in the world. The new trading ring will help to improve the trading environment and will be able to cope up with further increase in the volume of business. After completion of the second phase an additional 32,000 sq. ft. area would be available to the Exchange administration and the members for their use which will go a long way in bridging the acute space shortage faced by the Exchange and the members at present.

Integrated Telephone Network

The Bombay Stock Exchange has placed an order on Tata Telecom for a 500 trunk, 2500-extension EPABX system. The total cost for turnkey execution of the project by the supplier is Rs. 11.5 million. Work relating to installation of this equipment has already commenced and it is expected to be operational from the beginning of 1992. It is planned to establish an All India network connecting various Stock Exchanges in the country thereafter, which
would enable members in different centres to communicate instantly with one another, paving the way for creation of a sound technology base on a national scale.

INVESTMENT OPPORTUNITIES FOR OVERSEAS INVESTORS

Investment in Indian stock markets at present is not fully open to foreigners. Foreign investment is subject to well defined and comprehensive provisions embodied in the Foreign Exchange Regulation Act of 1973. Direct foreign investment is now allowed up to 51% of the equity capital in high priority industries, generally known as Appendix I industries. In case of certain industries, investment up to 100% of the equity capital is permitted on a repatriable basis. Direct investment on stock markets is not allowed to foreigners except the non-resident Indians. However, foreigners can invest through the intermediation of country funds of offshore mutual funds floated for the purpose. Direct foreign investment is also permitted in case of specific funds floated by organisations such as the Asian Development Bank or the Commonwealth Development Corporation.

Non-Resident Indian Investments

While foreigners as a rule are not allowed to invest in the securities market, non-resident Indians are encouraged to invest in Indian securities both on repatriable and
non-repatriable basis. Facilities provided to non-resident Indians are also available to a company predominantly owned (atleast 60%) by the non-resident Indians. Through the 1982-83 and 1983-84 Budgets, the Government extended a series of liberal measures for attracting non-resident Indian investments. These included the following:

(i) Investment in new issues of companies on full repatriation basis was allowed upto 40% of the new issues of equity and preference capital of the new or existing company raising a public issue through prospectus. This facility was also made available to investment in convertible securities. Investment in capital raised by either private or public limited companies other than through the issue of prospectus was also permitted upto 40% of the issued capital subject to a ceiling of Rs. 4 million. In the case of priority sector industries and companies undertaking to export 60% of the output which is raised to 75% in case of industries reserved for the small scale sector, the extent of investment was permitted to the extent of 74%.

(ii) Portfolio investment in shares and convertible debentures was also liberalised with full
benefits of repatriation provided they are purchased through a stock exchange, the purchase by a non-resident Indian does not exceed one per cent of the paid-up capital of the company and the investments are either through fresh remittances from abroad or through NRE/FCNR accounts with a bank in India. An overall ceiling of 24% of the paid-up capital of company was imposed on total non-resident Indian investments under the portfolio scheme. There are, however, no limits on investment in non-convertible debentures and Mastershares of the Unit Trust of India.

(iii) Non-resident Indians are permitted to subscribe freely on a non-repatriable basis to the new issues of any public or private limited company engaged in any business activities except real estate business and agricultural/plantation activities. Such investments are allowed upto 100 per cent of the issued capital of the investee company.

OCBs are taxed at 25% of their dividend and interest income and at 65% in the case of any other income. No surcharge on income tax is payable by NRI's and OCBs.
There are special tax concessions available to investment by non-resident Indians. These include the following:

(i) Investment income from specified "Foreign Exchange Assets" i.e., shares in Indian companies, debentures of a public limited company, deposits with a public limited company, etc., are subject to income-tax at a flat rate of 20 per cent. Long-term capital gains accruing from transfer of these specified "Foreign Exchange Assets" are also subject to income-tax at a flat rate of 20 per cent.

(ii) Investment in "Foreign Exchange Assets" are exempt from wealth tax.

(iii) When the total income of non-resident Indians consists solely of investment income and/or long-term capital gains on which tax at the flat rate of 20% has been deducted at source, then the non-resident Indian is not required to file a return.

Even though non-resident Indians have been provided extensive incentives for investment in India their response so far has been modest. As on the 30th
November, 1989, total direct investment of non-resident Indians in India was to the tune of Rs. 16.72 billion while under portfolio scheme they had invested Rs. 731.6 million in Indian securities. It is estimated that the total investible funds of non-resident Indians as a group are in excess of Rs. 1,500 billion. Thus their investments in India at present are a little over one per cent of their total investible funds.

**Offshore Mutual Funds**

While direct foreign investment in India is not permitted except for the investment by non-resident Indians as already indicated earlier and through collaboration arrangements for others, a via media has been found through floatation of country funds and offshore mutual funds. Several countries across the globe have tapped this source very successfully and India joined their rank through the launching of India Fund in London during 1986 by the Unit Trust of India, the major mutual fund operator of the country. This fund of the size of $ 110 million was succeeded by another fund, "India Growth Fund" launched by UTI once again, in New York in 1987 which had mobilised U.S. $60 million. In 1989 the State Bank of India launched a private placement mutual fund "India Magnum Fund" in Antilles, Netherlands and following overwhelming response the fund was closed at $ 156 million. In 1990 Canbank floated the Himalayan Fund for $ 100 million. Several more of such funds are being
structured by various operators to cater to different types of investors and will be launched in the days ahead. Agencies like Asian Development Bank and Commonwealth Development Corporation have also shown keen interest in the Indian stock market and a part of the proceeds that these institutions are mobilizing for investment in their constituent countries will be invested in the Indian stock market securities. All these offshore funds have so far raised over US$ 550 million.

Performance of the country funds from India has been heartwarming. India Fund and India Growth Fund after an initial lacklustre performance have been among the best performers within the several country funds.

For offshore mutual funds, the Union Budget for 1991-92, reduced the tax on dividends from Unit Trust of India and mutual funds from 25% to 10% and tax on long-term capital gains only on sale of such units of Unit Trust of India and mutual funds has also been reduced from 45.5% to 10%.

INDIA DEVELOPMENT BONDS (IDBs)

The Government of India has recently announced two schemes to attract a larger inflow of Foreign Exchange to the country. One of these schemes is the India Development Bonds (IDBs).
IDBs are US dollar and pound sterling denominated fully repatriable instruments maturing after 5 years from the date of allotment. These are issued exclusively for NRIs/OCBs controlled by NRIs and banks acting in a fiduciary capacity on behalf of NRIs/OCBs.

US dollar denominated IDBs are being offered in various denominations ranging from US $ 500 to US $ 50,000 and have a coupon rate of 9.5% p.a. payable half yearly for the non-cumulative option and compounded half yearly in the case of a cumulative option.

Pound sterling denominated IDBs are being offered in various denominations ranging from £ 250 to £ 20,000 and have a coupon rate of 13.25% p.a. payable half yearly for the non-cumulative option and compounded half yearly in the case of a cumulative option.

IDBs have full repatriation benefits (for both interest and principal) to NRIs/OCBs.

NRIs/OCBs and the first resident donee will enjoy guaranteed total amnesty and immunity in addition to exemption from Income, Wealth and Gift taxes in India.

IDBs are freely transferable between NRIs/OCBs/Persons Resident in India.
CONCLUSION

The Indian stock markets, which attained a remarkable degree of growth in the last one decade, have still a long way to go as investments in corporate securities and the various schemes of the mutual funds account for not more than 8 per cent of the financial savings of the household sector as against about 25 per cent in several of the advanced countries of the World. The process of modernisation and computerisation which has already started will soon be accelerated in order to render the markets not only broad and liquid but also fair and efficient and thereby allure a larger flow of funds into the market. All concerned with the market, the investors, the issuers and the market players and more importantly the regulators - the stock exchange authorities, the Securities and Exchange Board of India and above all the Government of India - have, however, an arduous task ahead of them. With sustained efforts on the part of all these, the Indian stock markets can easily prove to be not only fountains of eternal source of funds but also vehicles for distribution of wealth to an ever expanding population of investors in the country.
# Annexure I

## CAPITAL RAISED ON ALL-INDIA BASIS
(Amount in million Rs.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Preference</th>
<th>Debenture</th>
<th>Total</th>
</tr>
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<tbody>
<tr>
<td>1960</td>
<td>703.8</td>
<td>77.8</td>
<td>93.9</td>
<td>875.5</td>
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<tr>
<td>1965</td>
<td>680.6</td>
<td>105.5</td>
<td>216.2</td>
<td>1,002.3</td>
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<tr>
<td>1970</td>
<td>637.1</td>
<td>110.8</td>
<td>119.2</td>
<td>867.1</td>
</tr>
<tr>
<td>1975</td>
<td>634.3</td>
<td>48.6</td>
<td>301.5</td>
<td>984.4</td>
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<tr>
<td>1981-82</td>
<td>2,430.6</td>
<td>26.5</td>
<td>3,156.0</td>
<td>5,613.1</td>
</tr>
<tr>
<td>1985-86</td>
<td>8,350.5</td>
<td>10.1</td>
<td>7,981.8</td>
<td>16,342.4</td>
</tr>
<tr>
<td>1986-87</td>
<td>10,294.7</td>
<td>-</td>
<td>17,407.0</td>
<td>27,701.7</td>
</tr>
<tr>
<td>1987-88</td>
<td>8,099.9</td>
<td>-</td>
<td>6,642.0</td>
<td>14,741.9</td>
</tr>
<tr>
<td>1988-89</td>
<td>11,500.0</td>
<td>-</td>
<td>24,000.0</td>
<td>35,500.0</td>
</tr>
<tr>
<td>1989-90</td>
<td>12,450.0</td>
<td>50.0</td>
<td>49,000.0</td>
<td>61,500.0</td>
</tr>
<tr>
<td>1990-91</td>
<td>13,587.0</td>
<td>63.7</td>
<td>30,730.2</td>
<td>44,380.8</td>
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