NATIONAL STOCK MARKET SYSTEM

The Stock Exchange
Bombay
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NATIONAL STOCK MARKET SYSTEM

BACKGROUND

The High Powered Study Group on Establishment of New Stock Exchanges in its report submitted on the 30th June, 1991 has recommended the establishment of a National Stock Market System and a National Stock Exchange. Their major recommendations are as under:

NATIONAL STOCK MARKET SYSTEM

2. The Study Group has recommended establishment of a National Stock Market System with a three-tier stock market structure as under:

(i) Principal Stock Exchanges comprising of the five major Stock Exchanges at Bombay, Delhi, Calcutta, Madras and Ahmedabad.

(ii) Regional Stock Exchanges comprising of other Stock Exchanges, and

(iii) Additional Trading floors sponsored and managed by either a Principal Stock Exchange or a Regional Stock Exchange.

3. To provide for “uniform and high quality trading, settlement, clearing and depository services” for such a nation-wide system, the Study Group has also recommended the following support agencies:
(i) A National Clearing and Settlement Corporation to administer the clearing and settlement functions at a national level proposed to be set up under the aegis of Stock Holding Corporation of India Ltd., (SHCIL).

(ii) A Central Depository Trust to eventually usher in scripless trading to be organised by SHCIL.

(iii) A Securities Facilities Support Corporation which would be entrusted with the task of establishing and maintaining the network.

NATIONAL STOCK EXCHANGE

4. After applauding the working of the Bombay Stock Exchange for setting the pace of the market, providing "unprecedented liquidity in all major counters", etc., the Study Group recommends that "a new Stock Exchange be promoted immediately at New Bombay as a Model Exchange and to act as National Stock Exchange with a capital outlay of Rs. 30 crores to be financed by admitting 1,000 members with an entry fee of Rs. 10 lakhs each with the fee for corporate and institutional members being pegged at a higher level of Rs. 25 lakhs each. The Study Group also recommends that the National Stock Exchange could limit itself to listing only medium-sized companies in order to play a complementary role to the role played by the Bombay Stock Exchange. In addition to listing medium-size companies, public sector units could also be listed on this Exchange. The Study Group anticipates that, "with the growth in the level of their operations, companies that are initially listed on the National Stock Exchange would eventually graduate for listing on the Bombay Stock Exchange. Thus, the structure of the
National Stock Exchange is envisaged to be similar to that of the American Stock Exchange, which performs a wholly complementary role to the New York Stock Exchange System”.

5. In addition, the National Stock Exchange could focus on creating a market for debt instruments which according to the Group is “an area that is currently wholly neglected by the Bombay Stock Exchange”. The National Stock Exchange like all other Stock Exchanges in the National Stock Market System would also prove to be accessible directly to a wide cross section of potential investors from other urban, semi-urban and rural areas and thus work as an integrated component of the National Stock Market system.

PURPOSE OF THE DOCUMENT

6. The Bombay Stock Exchange has studied the above proposal from a totally objective angle solely from the point of view of the development of a healthy and orderly capital market in the country taking duly into account the interest of investors on the one hand and rendering the market efficient and cost-effective for the issuers on the other.

7. This document has, therefore, been prepared to present our views in the light of the proposals made in the report of the High Powered Study Group on Establishment of New Stock Exchanges.

8. We have also attempted to clarify certain facts in areas where we believe there are certain distortions in the report.

9. Our recommendations and the rationale is presented in the following sections.
10. The growth of stock market activity, no doubt, has reached a stage where the establishment of an integrated National Stock Market System has become an absolute necessity. The question, however, is the modality of establishing such a system. It is not at all necessary, nay even desirable, to establish a separate Stock Exchange to achieve this objective. This objective can well be achieved under the existing set up itself by a more economical and less time-consuming process.

11. A Central Depository Trust is actually part and parcel of the National Stock Market System. The recommendation of the Study Group for the devolvement of the functioning of Central Depository Trust to the Stock Holding Corporation of India Ltd. is, therefore, wholly endorsed by this Exchange. In fact, we consider this suggestion to be the most important one for ushering in the National Stock Market System in the country.

CONCEPT OF NATIONAL STOCK MARKET SYSTEM

12. Before one speaks about the National Stock Market System, it is necessary to know as to what exactly is meant by the System. The concept of a National Stock Market System in this country is still in a nebulous stage lacking clarity of thought not to speak of lack of the wherewithal to implement such a system. The primary objective of a National Stock Market System should be to provide equal opportunity to all investors throughout the country to trade in any security irrespective of the size of the order or the broker through whom the order is routed. In a nutshell, it means the facility to execute the buy order at the lowest price in any stock market located anywhere.
in the country and to sell at the highest price prevailing anywhere in the country without any extra cost to the investor. It does not in anyway mean one single market assimilating all buy and sell orders at a single point or through any single agency, whatever its name be and this is particularly so in a country like India, so diverse and so vast. Such a system necessarily envisages multiple listing of companies providing for markets in the same scrip in different centres and multiple membership of Stock Exchanges facilitating easy accessibility by the same member to different markets with the investor located in one market not being called upon to pay any extra brokerage for execution of his order at another centre and linking up of all these Stock Exchanges. While the National Stock Market System is thus a must, the question basically is one of working out the modalities of establishing such a system and not of setting up a separate Stock Exchange.

13. Linking of exchange market facilities into a formal National Stock Market System would require the different Stock Exchanges and their regulators to work beyond just cooperation. All the regulatory arrangements have to be made applicable to all Stock Exchanges. These would necessarily have to be carefully drawn out to commit each market involved in the system to assume certain self-regulatory responsibilities.

14. Typically, such arrangements should include the following:

- coordination with and communication of relevant information to each other in respect of quotation, trading suspension and resumption, etc.,

- sharing of regulatory information as needed by any party
for purposes of their local surveillance,

e - exploration of concerted regulatory initiatives, such as development of uniform standards for transactions in scrips listed at multiple centres, and

15. The arrangements listed above can only be formulated and later coordinated by the apex regulating body in the country, i.e., the Securities and Exchange Board of India. The formulation and overseeing of the national regulatory framework cannot be left in the hands of any individual Stock Exchange.

DEVELOPMENT OF NATIONAL STOCK MARKET SYSTEMS WORLD OVER

16. The first one in the world to establish a National Stock Market System, although they did not call it so, was the United Kingdom and the Republic of Ireland. All the seven Stock Exchanges in the United Kingdom and the Republic of Ireland merged way back in 1973 to form the International Stock Exchange of the United Kingdom and the Republic of Ireland with London as the hub of the inter-market system and only floors being established at other centres viz., Liverpool, Belfast, Birmingham, Glasgow, Manchester and Dublin.

17. In the United States of America, which is the home of the National Stock Market System, the Securities Acts Amendments of 1975 directed the Securities and Exchange Commission (SEC) to use its authority to facilitate the establishment of a National Market System. The SEC left the actual design of the National Market System to the securities industry. In 1977, the New York Stock Exchange was the first to develop a system known as the Intermarket Trading System (ITS). Actual trading in the ITS
commenced on the 17th April, 1978 with the linkage of the New York Stock Exchange and the Philadelphia Stock Exchange. Subsequently, on the 7th August, 1978, the linkage was expanded to include the American Stock Exchange, the Boston Stock Exchange, the Midwest Stock Exchange and the Pacific Stock Exchange. In June, 1978, the Cincinnati Stock Exchange developed a slightly different system called the National Securities Trading System (NSTS). A manual interface between these two systems was established on the 11th February, 1981. The National Association of Securities Dealers also joined the ITS in April 1982 through its Computer Assisted Execution System. The development of the ITS did not necessitate the setting up of a new Stock Exchange.

18. The crucial adjuncts to the ITS are the composite quotation displays in each participating market centre. These displays show the current quote for each eligible stock in that market centre and either the current quotes in all other participating market centres or the best quote available system wide. A broker or market-maker in any market centre can thus exercise his own judgement in determining on the basis of current quotations whether to execute his own order or his customer's order with the market centre in which he is physically present or whether to seek an execution in another participating market centre. Once he decides to execute the order in another market, all that he has to do is to enter into a computer terminal located on the floor of his exchange a "commitment to trade" which is a firm obligation for a fixed period of time on his part to buy or sell the specified number of shares of the specified security at the specified rate. This is delivered or queued for delivery to the destination market centre's output terminal in a matter of seconds. If the
commitment is accepted by a broker or market maker at the receiving market centre, a short message is entered into the system and the system quickly reports an execution back to the originating market centre. If the commitment is not accepted during the designated time-period, the commitment is automatically cancelled. A commitment to trade can also manually be rejected within the designated time period. In that event, the cancellation is reported back to the originating market.

19. The eight regional exchanges in the Federal Republic of Germany were linked in 1989 nationally under IBIS – a screen based trading system—wherein Frankfurt, which accounts for nearly two-thirds of the turnover of stocks in Germany was linked to other Stock Exchanges in Germany and no new Stock Exchange was set up to establish such a linkage. Similarly, Stock Exchanges in advanced markets like those of France, Switzerland, Australia, New Zealand, etc. are developing links with the principal Stock Exchange of the country for a closer integration with the principal Stock Exchange and not establishing any new Stock Exchange to facilitate such an integration.

CONSTRAINTS IN THE EXISTING SYSTEM

20. The several constraints in the existing system pointed out in the report of the Study Group in favour of the establishment of the National Stock Exchange have their origin in the very system of the securities industry of the country and the environmental conditions and these issues need to be addressed to improve the system. Superimposition of a new structure into the system without removing the existing constraints can
aggravate the problem without in any way offering any solution to the complex set of issues facing the securities industry. The report of the Study Group amazingly contains distortions too.

LACK OF LIQUIDITY

21. The Study Group erroneously states that on the Bombay Stock Exchange daily transactions are carried out in about 250-300 companies and weekly transactions in another 500-600 companies and that other scrips are either traded infrequently or are not traded at all. This is far from true.

22. Liquidity in the Bombay Stock Exchange has improved by leaps and bounds in recent years. In fact, trading used to be in securities of 250-300 companies even in the early 80s when investor interest in securities was relatively at a low ebb. Currently securities of over 1,400 companies are traded daily on the Bombay Stock Exchange out of which securities of about 750 companies are traded daily and on a continuous basis. This is also evident from the following table which gives the average daily turnover since 1985.

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Daily Turnover (In Rs. Cr.)</th>
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<tr>
<td>1985</td>
<td>29.92</td>
</tr>
<tr>
<td>1986</td>
<td>67.98</td>
</tr>
<tr>
<td>1987</td>
<td>39.55</td>
</tr>
<tr>
<td>1988</td>
<td>82.38</td>
</tr>
<tr>
<td>1989</td>
<td>127.42</td>
</tr>
<tr>
<td>1990</td>
<td>189.15</td>
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<tr>
<td>1991 (till August)</td>
<td>203.91</td>
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23. In fact, the daily average turnover in June, 1991 had shot up to Rs. 340.89 crores.

24. Trading activity in other securities is sporadic not because of the disinterest of brokers in the scrips but because of specific characteristics of issuer companies such as an extremely low capital base with as many as 571 companies out of 2,275 listed companies as on the 31st March, 1989 having an equity capital of less than Rs. 50 lakhs, lack of adequate floating stock in the market because of the closely-held nature of these companies and poor track record of these companies. There is thus no genuine investor interest in any of these companies without which it will just not be possible to develop trading in their securities. It is pertinent to observe in this connection that equities of almost all the companies listed during the last three years or so are traded regularly mainly because of stricter listing requirements, the emphasis being a larger equity base - the present stipulation for getting listing is an issued capital of Rs. 3 crores - and also a larger quantum of offer to the public. The answer for ensuring a greater degree of liquidity in listed securities, therefore, lies in stiffening the listing regulations by prescribing conditions such as continuous declaration of dividends, minimum percentage of public shareholding, etc. as is done in most of the developed markets of the world and also working out the modalities for the functioning of market-makers. These are the areas that need to be looked into to enhance liquidity and not establishing a similar institution to achieve these objectives which can only be an exercise in futility.

25. The allegation about lack of depth and breadth is not true. Despite drastic restrictions in trading, the daily volume o
turnover at the Bombay Stock Exchange is over Rs. 200 crores in the current year. The jobber's spread in pivotal shares in the Bombay Stock Exchange is less than 0.5 per cent which is lower than the spreads in most of the quote-driven markets of the world. For example, the spreads in the comparable active scrips on the London Stock Exchange called Alpha Stocks averaged 1.8 per cent at the end of the first quarter of 1991.

DEBT INSTRUMENTS

26. The report also speaks about lack of liquidity in debt instruments. This conclusion is based on wrong premises. The convertible debentures which are quasi-equity by nature are actively traded in the market with their quotations being published almost daily. There are several regular jobbers dealing in non-convertible debentures too in the Bombay Stock Exchange, particularly in the last two to three years, and non-convertible debentures of several companies do enjoy a good market with the demand often outstripping the supply. It is only non-convertible debentures of companies having a poor track record that fail to develop a market because of investor apathy. Absence of any credit rating of non-convertible debentures also disables investors, particularly individuals, to make any distinction among the non-convertible debentures of different companies. Yet another reason for lack of adequate interest in these instruments is fixed rates of interest, in operation till recently, on these instruments in the primary market irrespective of the prevailing rates of return at the time of issue and the nature of issuer companies which in turn limits the range of fluctuations in market prices in the secondary market.
27. The secondary market in non-convertible debentures is expected to undergo a sea change because of adoption by the Government of India of the policy of deregulation relating to interest on these instruments. Pursuant to the announcement made by the Finance Minister in his 1991-92 Budget speech, Ministry of Finance, in a press note issued on the 6th August, 1991, withdrew all restrictions on interest rates on debentures and public sector bonds other than tax-free bonds of public sector undertakings. Companies are also required to obtain a rating for their debt instruments from credit rating agencies before floating debentures.

28. The deregulation of interest rates by itself is a great prop for the secondary market as there has to be a constant adjustment in prices related directly to the day to day changes in the interest rates in the primary market which in turn is related to a host of other factors, mainly the prevailing interest rates in the money market, the lending rates of commercial banks and financial institutions, etc. The requirement to have credit rating of non-convertible debentures before issue will also lead to a greater degree of fluctuations in the secondary market as the issuing rates in the primary market will no more be uniform. Fluctuations in prices that will be caused by all these factors will lead to an active and thriving secondary market in non-convertible debentures. In fact, in most of the developed global markets, the turnover in the bond market is more than that in equities and the Bombay Stock Exchange will also soon emerge as a nerve centre of activity in these instruments. The Exchange will soon come out with concrete plans to encourage development of such a market by having a separate counter for bonds, appointment of authorised dealers in bonds with special facilities, etc.
29. It needs specifically to be pointed out in this connection that there is quite an active secondary market in Government Securities and Bill Discounting involving hundreds of crores of rupees, despite the fact that this market is a captive market, the players in the market being only commercial banks and financial institutions because of the statutory liquidity ratio requirements and provident and gratuity funds again because of the statutory stipulations. Despite such constraints, the market has been developed and sustained by the members of Stock Exchanges. This only goes to prove that stockbrokers have the necessary capacity to develop any market provided, of course, the basic prerequisites for the development of the market exist.

COMPUTERISATION AND MODERNISATION PROGRAMMES OF STOCK EXCHANGES

30. The report of the Study Group also talks about the outdated trading and settlement systems. The report unfortunately does not make any mention about the constant technological upgradation, developments and innovations which are regularly taking place in the trading and settlement systems of Stock Exchanges nor does it cover the future development plans of either Bombay Stock Exchange or any other Stock Exchange in the country.

31. Computerisation was introduced at the Bombay Stock Exchange in a small way two decades ago in 1971. Progressive upgradation of the process of computerisation has been going on in right earnest since then. But for this, the Exchange would not have been able to handle the steep increase in the number of trades which was less than 10,000 a day about a decade ago to over 100,000 a day currently beating all the leading global
markets of the world like Tokyo, New York and London Stock Exchanges whose daily trades are much lower and that too put in a longer trading period of four to six and a half hours.

32. To cope up with the increasing turnover, the Exchange has recently installed an ICIM Series 39 mainframe computer, at a cost of Rs. 1.13 crores which has augmented the computing capacity from about 50,000 trades a day to 1,50,000 trades a day. While this will take care of the immediate needs of the Exchange, a large mainframe computer connected to the offices of the members by terminals will be installed later. The computer system will support online processing, and at the same time, facilitate real-time display of trade information, so as to inject complete transparency to trading. It would also enable the setting up of a value-added information service, which would be useful to the members, and more particularly, the investors and media. More than 60% of the operations of the members of the Exchange are already computerised, and most of them submit their transaction details on computer floppies instead of hand written documents. The operations of all members are expected to be computerised by mid-1992. The entire project is being implemented by CMC Ltd., a leading Government owned Information Technology company in the country.

33. It is relevant to note in this connection that a Study Team comprising of the President, Executive Director and senior officials of this Exchange, along with representatives of CMC, had undertaken a tour of the stock exchange centres at London, New York, Rio de Janeiro, Tokyo, Hong Kong, Kuala Lumpur and Singapore in October, 1989. An exhaustive assessment of systems in the areas of trading, settlement and information dissemination in these exchanges was made, so that a state-of-
the-art framework could be implemented at the Bombay Stock Exchange. Over the last one year, CMC has had extensive discussions with the members and officials of the Exchange and in addition, with the representatives of Financial Institutions. This has provided CMC with an enormous insight into the operations of the stock exchanges and they have already submitted the Project Report explaining the scope and phases of implementation. The Exchange has also received clearance from the Department of Electronics (DoE), Government of India, to float limited global tenders for the computer and communications hardware required for this project. The Exchange is currently engaged in formulating specifications for the tender and would very shortly be floating limited global tenders for the hardware. The project is being implemented in four phases, as under:

(i) Phase-I, providing for dissemination of two-way quotes, company and Exchange announcements, indicative transaction prices, etc., on display devices in respect of all specified shares and 200 active non-specified shares to come into effect in the first quarter of 1992.

(ii) Phase-II, establishing a network connecting individual member offices with the central Exchange computer and providing for input of transactions and other data required for the existing batch settlement system, transmission of processed information to members and online reconciliation facility for unmatched transactions, to be operational in the second quarter of 1992.
(iii) Phase-III, providing 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 to be introduced from the latter half of 1992.

(iv) Phase-IV, extending the coverage of the automated trading system to include even the most actively traded scrips in the non-specified group to be introduced in the first half of 1993 after gaining experience of implementation of the first three phases.

34. With the highly sophisticated systems detailed above which will cost the Exchange over Rs. 70 crores, trading and settlement on the Bombay Stock Exchange will be on par with those of the most developed markets. A major offshoot of these developments would be the creation of a technological infrastructure which would enable the linking up of markets at different centres to facilitate inter-market trading thus evolving into a national market system. Extending these links to the major international exchanges would only be a simple step thereafter.

STATE-OF-THE-ART TRADING RING

35. Construction of Phase II of P.J. Jeejeebhoy Towers in which the Stock Exchange is housed is nearing completion. This contains the new Trading Ring of the Exchange admeasuring about 19,000 sq. ft. with all the state-of-the-art features. This ring as such can form the nucleus of the National Stock Market System. Phase II of the building, with all the modern
amenities, including the escalators, has cost the Exchange about Rs. 15 crores. The new ring will be inaugurated in January, 1992.

DEPOSITORY

36. The Bombay Stock Exchange have also set up BOI Shareholding Ltd. in collaboration with the Bank of India, which will effect transfers involved in a settlement by mere book-entries. This depository will work in close collaboration with the Stock Holding Corporation of India which would perform the functions of a Central Securities Depository in the country. It is our endeavour to move towards a certificateless society for which we had submitted a blueprint to the Government of India way back in 1979. We will be giving priority to this and render all assistance to all concerned to establish such a society with the deployment of the latest technology in the field.

EPABX TELEPHONE SYSTEM

37. With a view to ensuring reliable and speedy communication among members and others connected with the Stock Exchange, a large EPABX system with 500 trunk and 2500 extension lines has already been ordered on Tata Telecom Ltd. at a cost of Rs. 1.15 crores and will soon be installed. This will connect the members of the Exchange and other related organisations like Financial Institutions, and will completely transform the voice communication set-up the Exchange has at present. This is expected to be operational from the beginning of 1992.

38. It is the sincere endeavour of the Bombay Stock Exchange to have an exclusive all-India network connecting various Stock
Exchanges and all the related Financial Institutions in the country so that the various participants of the securities industry could communicate with one another instantly.

ELECTRONIC TELEPHONE EXCHANGE

39. The Exchange is presently carrying on a dialogue with the Manager Telephone Nigam Ltd. for setting up an electronic telephone exchange exclusively for the Bombay Stock Exchange in order to enable small, large and institutional investors from all over the country to communicate with the members of the Exchange speedily and easily. The Exchange is quite hopeful in this regard despite lack of space for the location of the telephone exchange being a serious constraint.

CONSTRAINTS TO BE REMOVED

40. The Bombay Stock Exchange has undertaken all the above modernisation and computerisation programmes despite several constraints like lack of space – 54 per cent of the area in the present Phase I of P.J. Jeejeebhoy Towers is occupied by Financial Institutions and Nationalised Banks – resource crunch, etc. The strong determination the Stock Exchange authorities have, however, been able to face these problems in stride. As a result, the Exchange is bound to emerge as a major market in the global scene in the near future.

41. The various other sister Stock Exchanges, major as also minor, are all also set on the path of modernisation and computerisation despite all of them being faced with several constraints, particularly finance, like the Bombay Stock Exchange. The Standing Committee of Presidents of Stock
Exchanges has, therefore, been repeatedly pleading for Governmental assistance in matters of allocation of space, prevailing upon the Government controlled institutions to vacate the spaces occupied by them in Stock Exchange premises, grant of funds, etc. With the emergence of the capital market as a major source of finance for the industry and trade, it is hoped that Government would pay heed to these repeated pleas made by the Stock Exchange fraternity.

42. As the Stock Exchanges thus move in tandem to usher in an efficient market in terms of trade support and settlement systems, a major bottleneck that needs to be removed to enable this country to move into the global objective of ushering in a rolling T+3 settlement system (i.e., settlement in terms of delivery of shares and payment of price on the third day after the trade day) as laid down by the Group of 30 experts from the leading global markets of the world, is relating to physical delivery of shares with the dated transfer deeds having a limited duration of validity till the next book-closure or one year from the date of stamping by the competent authority, whichever is later. In most of the developed markets of the world, the transfer deeds have been done away with and securities move mostly through book-entries. Unless this is attended to on a top priority basis, all sophistications aimed at rendering trading and settlement systems more efficient will fail to achieve the desired objective. It is only a matter of recent history that the New York Stock Exchange was forced to close down for a day in a week and also curtail the trading hours on other days in the early 70s because of the mounting paper work. The draft legislation pending before the Government of India permitting transfer of shares lying in depositories by mere book-entries dispensing with physical deliveries needs,
therefore, to be attended to. Equally important is to do away with dated transfer deeds which was introduced way back in 1966 due to certain malpractices by some companies prevention of which have already been taken care of by several amended provisions subsequently incorporated both in the Companies Act, 1956 and the Income-tax Act, 1961.

AN EFFICIENT SYSTEM WITHIN STOCK EXCHANGES - A FIRST STEP

43. The Study Group has overlooked the basic fact that for the evolution of a National Market System in any country, it is a condition precedent that the existing Stock Exchanges themselves are rendered more efficient in terms of trade support and settlement systems, as also depositories. As already detailed above, Stock Exchanges themselves are undertaking this stupendous task and all that is needed is to extend to Stock Exchanges the required amount of support in terms of finance, technical assistance and guidance. There is no need to set up another Stock Exchange to undertake this work.

ROLE OF SECURITIES AND EXCHANGE BOARD OF INDIA

44. What is really needed for the evolution of a National Stock Market System is a central regulatory authority to guide and to co-ordinate the activities of the various Stock Exchanges. As already indicated in para 10 above, the Securities and Exchange Commission with a congressional mandate, has been handling this work in the United States. As in the United States in India too, this important task can only be undertaken by the regulatory authority i.e., the Securities and Exchange Board of India, who can if it comes to that order the hesitating Stock Exchanges to fall in line with the System. Entrusting this work
to any other Stock Exchange can only lead to bickerings and quarrels totally detrimental to the system. This will also complicate the matter as routing the transactions through a third Stock Exchange, which could otherwise be done by two Stock Exchanges directly, will lead to unnecessary cost and time.

45. A small beginning in the evolution of a National Market System has already been made with the launching in August, 1987 of PTI Stockscan which has electronically linked up the five major markets of Bombay, Calcutta, Delhi, Madras and Ahmedabad with instant quotations of over 500 scrips traded on these Exchanges and other market-related information being continuously displayed not only at these centres but at several other centres in the country. Attempts are also being made to harmonise settlement periods at all major Exchanges. The proposal to set up a new Stock Exchange in New Bombay to be called the National Stock Exchange will not improve in any way the efficiency of the market leading to the benefit of the investors. There is also no certainty that trading will develop in this market. For example, the Stock Exchange at Pune with a vast hinterland of investors and located in the centre of a large industrial belt is a virtually dormant Stock Exchange with volumes of turnover of less than one per cent of the turnover on the Bombay Stock Exchanges.

WHY THEN ANOTHER STOCK EXCHANGE?

46. If the Securities and Exchange Board of India is to, as it should, take up the work of developing a National Stock Market System, the basic question then boils down to the need of having another Stock Exchange so close to the Bombay Stock Exchange which undoubtedly is the premier Stock Exchange of the country accounting as it does for over two-thirds of the business, both
in primary and secondary segments of the market. Nowhere in the world excepting in the city of New York, is there more than one Stock Exchange in one city. All the principal Stock Exchange centres in the World like London, Tokyo, Hong Kong, Rio De Janeiro, Frankfurt, Melbourne and Ottawa, have only one Stock Exchange. In fact, Hong Kong which had four stock exchanges in the past, have reorganised them into one exchange in view of the gross inefficiency with multiple exchanges. The only centre where there are two Stock Exchanges is the city of New York. In addition to the New York Stock Exchange, there is the American Stock Exchange which had sprung up in 1921, established mainly by kerb traders. The American Stock Exchange, however, is a miniscule market compared to the New York Stock Exchange with a meagre 3.9 per cent of the market capitalisation of the New York Stock Exchange (as on the 31st December, 1990) and a turnover which is just 2.8 per cent of the turnover of the New York Stock Exchange in 1990. Also the turnover of this Exchange has been showing a declining trend for the last several years. To cite this market as an example to set up two Stock Exchanges in the city of Bombay is a travesty of facts. The setting up of a 'National Stock Exchange' near the country's premier stock exchange, which is also the oldest in Asia, having been established in 1875, will confuse domestic as well as foreign investors, whom we have to woo assiduously.

47. The proposed National Stock Exchange, as already indicted in para 4 above, would be listing only medium-sized companies and also simultaneously it is proposed to list public sector units which are anything but medium-sized. The objectives of this Exchange are, therefore, not clear. Be that as it may, there is no need whatsoever to set up another Stock Exchange. Enlistment of small companies and for that matter of
fact medium-sized companies can easily be done through the OTC Exchange of India which has been arduously working for the establishment of such a market. Trying to inject something in between the OTC Exchange of India and the other Stock Exchanges of the country will only create confusion among the investors. The recent experience of U.K. to create a third market in addition to the Main Market and the Unlisted Securities Market was a disastrous failure. It is, therefore, all the more necessary to ensure that we do not do anything of this type when we are seriously involved in finding out ways and means of opening our markets to foreigners who are knocking at the doors of the Indian markets.

48. The scenario becomes more confusing because of the proposal to admit 1000 members with 75 per cent of them being corporate and institutional members and the remaining 25 per cent being members of existing Stock Exchanges. This is clearly indicative that this Exchange will run as a parallel organisation, and not just a small institution to list only medium-sized companies and public sector units as is made out by the Study Group. Such a development will definitely fragment the business of the Bombay Stock Exchange. The efficient functioning of Stock market in Bombay, which has been lauded both within the country and outside for its breadth and depth being a highly liquid market, will definitely be affected. While competition in the case of products among the producers leads to an improvement in quality and reduction in price to the benefit of the consumer, in the case of stock markets, it fragments the players among the Exchanges and thereby reduces the competitive character of the market by a shrinkage in the number of transactions in any one of the markets. Stock changes do not offer any commodity or product for sale but is

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only a meeting place to hold an auction and the price is
determined by the number of operators who participate in the
auction. The fewer the number, the smaller are the number of
transactions and less competitive the market. Such a
development will have two serious fall outs to the detriment of
the investor. First, the volatility of the market will
increase, as the imbalances in supply and demand can only be set
right by changes in levels of prices to establish equilibrium
between supply and demand. Fragmented markets either at the
main market or at the other market fragmenting the main market
can absorb large orders for purchase and sale only with sharp
oscillations in prices. Secondly and more importantly, the
spreads between bid and offer rates will increase in both the
markets. The investor will thus be called upon to pay a higher
price for the purchase and realise a lower price for the sale.

49. The short answer, therefore, is not to set up another Stock
Exchange but to take all possible measures to hasten the process
of computerisation and modernisation of Bombay Stock Exchange
together with those of other Stock Exchanges in the country so
that a well-knit background for the establishment of a National
Stock Market System gets structured. To form another Stock
Exchange in or around Bombay or for that matter anywhere in
India for this purpose can only result in confusion and
duplication of efforts.