ORGANISATION AND TRADING PRACTICES OF INDIAN STOCK EXCHANGES

By

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India has the privilege of having had the tradition of trading in securities for over two centuries. In fact, the oldest Stock Exchange in Asia is the Bombay Stock Exchange having been established in 1875 while the Tokyo Stock Exchange was founded three years later in 1878.

The stock market activities in India were relatively on a low key till the beginning of the decade of 80s mainly because of the alien regime till 1947 which concentrated more on administration and less on development and pursuit **of** the philosophy of the public sector dominating the economy by the independent India after 1947. The process of liberalisation and deregulation set in by the Government headed by late Shri Rajiv Gandhi as the Prime Minister since November, 1984 and followed more vigorously by the present Prime Minister since June, 1991 has altered drastically the complexion of stock market activities in India.

BURGEONING STOCK MARKETS

The Indian stock markets have grown so sharply in the 80s that the decade itself has been christened, inter alia as 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 primary market in the seventies, Rs.64.73 billion was raised during 1989-90 although during the next year i.e., 1990-91, there was a dip to Rs.42.30 billion. The amount raised from the primary market in 1991-92 again went up to Rs.57.49 billion and in the year 1992-93, about Rs.180 billion were raised. The number of listed companies rose over the decade from about 2,200 to over 6,500 catapulating this nation to the position of being next only to the United States of America, which had 6,742 listed domestic companies at the end of 1991. The daily turnover on the Indian stock markets shot up from about Rs.250 million in 1979-80 to about Rs.6 billion during the year ended 1991-92 although in the current year, it is hovering around Rs.4.5 billion. The number of shareholders and investors in mutual funds has also risen sharply from about 2 million to over 25 million during this period, rendering this nation to the position of having the second largest shareholding population, next only to the United States of America. Market capitalisation has also increased from about Rs.35 billion to over Rs.2,500 billion during the last one decade, accounting for about 40 per cent of the GNP now as against about 5 per cent ten years ago. This compares favourably with the average of about 25 per cent of European countries although well below of over 75 per cent of U.S.A., U.K. and Japan. The number of stock exchanges has also grown from just nine in the beginning of 80s to 21 currently. Besides, there is the OTC Exchange of India spreading its trading activities right across the country like the NASDAQ of U.S.A.

India is now a major player in the emerging markets of the world, next only to Mexico, Korea and Taiwan both in respect of market capitalisation and turnover. In terms of U.S. dollars, the market capitalisation at the end of 1992 was $85.88 billion as compared to $138.74 billion of Mexico, $107.66 billion of Korea and $100.16 billion of Taiwan while the volume of turnover in the Indian stock markets during the year ended December, 1992 was $36.26 billion as compared to $ 236.68 billion in Taiwan, $ 116.80 billion in Korea and $ 58.8 billion in Mexico. Annexure I gives the details in this behalf.

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 about 5,500 active stockbrokers all over the country as against about 1,250 about ten years ago.

Stockbrokers are encouraged to amalgamate themselves into corporate entities for which the statute was specially amended in July, 1987. As this amendment required a majority of the directors of the corporate entity to be also members of the stock exchange in their individual capacity with unlimited liability, the statute has been further amended in November, 1992 enabling enrolment of a corporate entity directly as a member without the requirement of any individual director being a member of the stock exchange. This is expected to lead to the emergence of a number of corporate entities as members of stock exchanges in the near future.

The amendment to the statute 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.

GOVERNING BOARDS OF STOCK EXCHANGES

In tune with the developments the world over, complexion of the governing boards of the Indian stock exchanges too is undergoing a change, as more non-broker directors are being inducted into the boards of the stock exchanges. Presently, non-broker directors, who are generally representatives of the Ministry of Finance, Department of Company Affairs, Reserve Bank of India, Financial Institutions and Securities and Exchange Board of India (SEBI) - the newly formed watch-dog of the securities industry - and some leading personalities drawn from different professions including chartered accountancy, law, etc., constitute about one-third of the strength of these boards. SEBI has recently directed the stock exchanges to raise the strength of non-broker directors to 50 per cent with the Executive Director being reckoned separately.

PRIMARY MARKET

The decade of the 80s witnessed emergence of the 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.64.73 billion. In 1992-93, an amount of about Rs.250 billion constituting about 15 per cent of the gross domestic savings is expected to be raised. Even the public sector undertakings are taking increasing recourse to the primary market through the issue of bonds even though most of these bonds are privately placed with financial institutions and mutual funds. Annexure II gives details of the capital raised from 1960 through 1992-93 in Indian Rupees and US Dollars respectively.

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 and a memorandum accompaning the application form relating to the issue.

In order to enable potential investors to take a well informed decision, Schedule II of the Companies Act, 1956 sets out the matter in detail to be included therein. All merchant bankers authorised by SEBI are required to ensure that the prospectus and the memorandum conform to the set format before the same are submitted to SEBI for approval. A noteworthy feature of the new format is the inclusion of the management perception of risk factors (eg. sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials or in marketing of products, cost/time over-run, etc.) which are likely to significantly or materially affect the performance of the company based on the occurence of an event or a series of events.

The average size of capital floatation is also showing a significant increase. During 1991-92, the average size of an equity issue was Rs.47.7 million as against Rs.3.5 million in 1980-81. The average size of a debenture issue has similarly gone up to Rs.275.3 million during 1991-92 from Rs.112 million in 1980-81. This has happened because of reasons like companies under the present liberal conditions being encouraged to set up minimum economic size projects, capital intensity of the projects being increased, the changing preference of companies to access the stock market to mobilize funds rather than from banks and financial institutions, etc.

STOCK MARKET INSTRUMENTS

The Indian stock markets have not yet been able to develop a comprehensive range 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, have become quite popular. Non-convertible debentures were popular with investors, in the first half of the 80's, because of the progressive rise in the rate of interest on these debentures from 10.5 per cent in 1977 to 15 per cent in March, 1985. These debentures evoked a lukewarm response later when the maximum interest rate was scaled down to 14 per cent. The rate of interest was subsequently raised to its original level of 15 per cent to make it attractive to the investors. Since August 1991, the interest on debentures has totally been deregulated, with companies being given complete freedom to fix the rate of interest.

Credit rating for all debt instruments is compulsory except for public sector undertaking bonds enjoying tax benefits, private placements with financial institutions and banks, fully convertible debenture issues where the conversion is within 18 months from the date of allotment at predetermined price and issue of non-convertible debentures upto Rs.50 million to mutual funds or on private placement where credit rating is optional. Some of the top rated companies currently issue non-convertible debentures with rates of interst ranging from 16 per cent to 19 per cent.

The market for preference shares is virtually dead mainly because investors find the lack of security unattractive and issuers find it tax inefficient. Cumulative Convertible Preference Shares introduced by the Government in 1984 - an instrument giving fixed 10 per cent return during the gestation period of three years to five years and the benefits of equity thereafter- have also failed to catch investor interest as the rate of return was considered to be too low in the initial years and the provision for conversion into equity unattractive in the event the company failed to perform well.

A few companies have recently tried new instruments, hitherto alien to the Indian stock markets, such as warrants attached to non-convertible debentures carrying the right to subscribe to equity shares at the end of a specified period and zero-interest convertible bonds where the loss of interest is compensated by a lower price on conversion. Although it cannot be stated that these instruments have become popular with retail investors, they have been well received by institutional investors.

CREDIT RATING

Another significant development in the new issues market is the establishment of Credit Rating and Information Services of India Ltd., (CRISIL) set up jointly by the Unit Trust of India, Life Insurance Corporation of India, General Insurance Corporation of India, 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. 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 including industry risk, market position, operating efficiency of the company, track record of management, planning and control systems, accounting quality, 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 30th June, 1992, over 330 companies involving capital of over Rs.140 billion have been rated by CRISIL.

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).

SEBI GUIDELINES

Issue of capital by companies used to be regulated by the Capital Issues (Control) Act of 1947 and the various guidelines issued thereunder. The Act was repealed on 29th May, 1992. SEBI, however, issued on 11th, June, 1992 guidelines which are to be observed by companies issuing capital. The main provisions of the guidelines, among others are given below:

First Issue of New Companies:

A new company has been defined as one which has not completed 12 months of commercial operations and its audited operative results are not available, and where it is set up by enterpreneurs without a track record. Such companies will be permitted to issue capital to public only at par. Here the promoters' contribution shall be 25 per cent of the total issued capital for issues upto Rs.one billion and 20 per cent of total issued capital for issues over Rs.one billion with a minimum subscription of Rs.50,000 by each of the friends, relatives and associates. The lock-in period for promoters shall be five years from the date of allotment of the public issue or the date of commencement of commercial production (in case of a manufacturing company), whichever is later.

New Companies Set up by Existing Companies:

Where a new company is being set up by existing companies with a five year track record of consistent profitability, it will be free to price its issue provided there is participation by the promoting company to the extent of 50 per cent of the total issued capital and the issue price is made applicable to all new investors uniformly, and that the prospectus or offer documents shall contain justification for issue price. The lock-in period for promoters shall be the same as in the case of first issue of new companies, promoted by enterprenuers without a track record.

First Issue by Existing/Private Closely held/ Unlisted Companies:

(i) Companies without a three year track record of consistent profitability shall have to make a public issue at par where the promoters' contribution shall be 25/20 per cent of the total issued capital depending upon the size of the issue as explained in the case of first issue of new companies, with a minimum subscription of Rs.100,000 from each of the relatives, friends and associates. The lock-in period of promoters shall be five years from the date of allotment in the public issue or from the date of commencement of commercial production (in case of a manufacturing company), whichever is later. However, if the minimum specified percentage includes shareholdings held prior to the public issue, the lock-in period referred to above shall in respect of such prior shareholdings stand reduced by the period of such holding except that the aggregrate of minimum percentage holdings shall remain locked-in for a minimum period of two years from the date of allotment in the public issue.

(ii) Companies with a three year track record of consistant profitability can make a public issue at premium subject to the same promoters' contribution and lock-in period as mentioned above for companies without a three year track record of consistent profitability.

(iii) Companies which do not have a three year track record **but** have been promoted by existing companies with a five year track record of consistent profitability can make a public issue at premium provided the promoters' contribution is 50 per cent of the total issued capital and the lock-in period is same as in (i) above.

(iv) Companies without a three year track record of consistent profitability seeking disinvestment by offer to public without issuing fresh capital can make a public issue at par provided the minimum stake of promoters is maintained at 25 per cent of total issued capital after the public offer. Here the promoters' lock-in period is five years from the date of allotment in public offer.

(v) Companies with a three year track record of consistent profitability seeking disinvestment by offer to public without issuing fresh capital can make a public issue at premium subject to the same promoters' contribution and lock-in period as in (iv) above.

Public Issue by Existing Listed Companies:

These companies shall be allowed to raise fresh capital by freely pricing their further issues. Here the prospectus or offer documents shall contain the net asset value of the company, the justification for the price of the issue and high and low prices of the share for the last two years.

Here the promoters' contribution shall be:

(a) 25/20 per cent of the proposed issue, as the case may be, with a minimum subscription of Rs.100,000 from each of the relatives, friends and associates; or

(b) 25/20 per cent of the total issued capital, (expanded capital), as the case may be, with a minimum subscription of Rs.100,000 from each of the relatives, friends and associates.

Here the promoters' lock-in period shall be:

(a) 5 years from the date of allotment in the public issue or from the date of commencement of commercial production (in case of a manufacturing company) whichever is later; or

(b) the lock-in period shall, subject to clause (c) below, apply to the aggregate of the contributions made in the public issue and so much of the prior shareholdings as is necessary to constitute 25 per cent of the total issued capital.

(c) the lock-in period in respect of the contributions made in the public issue shall be five years from the date of allotment in such issue or from the date of commencement of commercial production (in case of a manufacturing company), whichever is later and in respect of the holdings prior to the date of the public issue shall be five years as reduced by the period of such prior holding except that such prior holdings shall remain locked-in atleast for a minimum period of 2 years from the date of the allotment in the public issue.

All firm allotments and preferential allotments to collaborators and shareholders of promoters' companies, whether corporate or individual, shall not be transferable for three years from the date of commencement of production or date of allotment wherever is later.

SECONDARY MARKET

The turnover in the Indian stock exchanges has increased significantly during the last ten years and particularly during the last three years. On the Bombay Stock Exchange, which accounts for about two-thirds of the business in India, the daily turnover shot up from

Rs. 131 million in 1980-81 to Rs.3338.5 million 1991-92 and was Rs.2392.4 million in the year 1992-93 as may be seen from Annexure IV.

What is remarkable about the Indian stock markets is the number of deals put through in a day. On an average, about 75,000 deals were executed in a day on the Bombay Stock Exchange alone in 1991-92 compared to about 1,07,139 deals on the New York Stock Exchange and about 20,099 deals on the London Stock Exchange during 1991. Often, when the market, is heated, the number of deals shoots to about 1,00,000 deals a day and taking into account the fact that trading is confined to only two hours in a day, which has recently been increased to three hours, 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. The criteria generally taken into account at present for shifting the shares from the group of non-specified securities to the specified group are:

(i) The company should have been listed for a period of at least three years.

(ii) The company should have an issued capital of at least Rs.75 million with a market capitalisation of 2-3 times thereof.

(iii) The number of shares publicly held should be at least Rs.45 million of face value.

(iv) The company must be on the dividend paying list and preferably be growth-oriented.

(v) Shares of the company should have been actively traded during the preceeding six months.

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 88,58,41 and 21 companies are classified as specified shares at the Bombay, Calcutta, Delhi and Ahmedabad stock exchanges respectively. With 45 shares being common among them, the number of companies whose equities are traded as specified shares is 135. 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 market 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 three hours from 11.30 A.M. to 2.30 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 two-way quotes for 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 actual practice, however, a class of jobbers have emerged who generally confine their activities to jobbing only. Since there are no serious regulations governing the activities of jobbers, the jobbing system is beset with a number of problems such as 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. Every effort is, however, being made to have compulsory market makers, reduce jobbing spreads and improve the depth of the market in thinly traded securities.

It is worth noting that in highly volatile scrips, the spread is by far the narrowest in the world being just about 0.25 to 0.50 per cent as compared to about 1.25 per cent in respect of alpha stocks i.e., the most highly liquid stocks on the London Stock Exchange. The spreads widen as liquidity decreases, being over 20 per cent, while the average spread of gamma stocks i.e., the least liquid stocks on the London Stock Exchange, is just about 6 to 7 per cent. This is basically because of the high velocity of transactions in active scrips. Shares in the specified group actually account for about 70 per cent of trading in the Indian stock markets. It is significant to note that over 1,600 securities get traded on any given trading day on the Bombay Stock Exchange.

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 by a relatively higher degree of volatility and illiquidity.

ON GOING DISCLOSURES

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 audited accounts within a period of six months from the date of closures of the accounts. Companies are also required to provide a Directors' Report alongwith audited accounts covering, inter-alia, material changes and commitments affecting the financial position of the company which have occured between the end of the financial year to which the balance sheet relates and the date of the report. Material changes, which have occured 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 notify to the stock exchange about its Board meetings to be held for declaration of dividend, rights 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 occurence and subsequently after its cessation, unaudited financial results on a half yearly basis within two months of the expiry of the period, etc. The agreement also provides for payment of dividend and interest at par at any bank at any centre in the country. The agreement further provides for intimation to the stock exchange by the company, the authorised intermediary and the acquirer, acquisition of securities in the company in excess of 5 per cent of the voting capital of the company by any person within two days and the offer to the securities holders of the company to acquire from them a minimum of 20 per cent of the total securities of the company whenever any person acquires securities carrying 10 per cent or more of the voting capital of the company or secures the control of management of the company by acquiring or agreeing to acquire, irrespective of the percentage of the voting capital, the securities of the directors or other members who control or manage the company, at a price not lower than either the average of the highest weekly prices duriong the preceding 26 weeks or the negotiated price, whichever is higher. Shareholders and the public are constantly apprised of the position of the company and attempts are made to prevent establishment of a false market.

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 takes about a fortnight both in respect of specified shares and non-specified securities. This is primarily due to the system of settling transactions in a batch mode. 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 reduce the period requied for settlement of transactions. In respect of non-specified securities, the period of trading has been reduced from 14 to 5 days effective from the 5th February, 1993, with the settlement being effected the following week. Subsequently a 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, is planned. 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 the simultaneous development of futures and options markets.

Share certificates and dated transfer deeds constitute a major hurdle in the growth of the securities business. With the establishment of the Stock Holding Corporation of India, which handles the shares of financial institutions, a move towards imobilisation/dematerialisation has already begun. In addition, the Bombay Stock Exchange has, in association with Bank of India - 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 specified shares ionvolved in carry-forward transactions worth about Rs.5 billion with the settlement of shares being effected by book-entries only. The services of the depository will later be extended to other activities of stockbrokers and to investors. Attempts towards evolution of 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 is already on.

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 already launched on a massive scheme of computerisation using about Rs.750 million.

Phase I of the project was commissioned on the 30th November, 1992 with the inauguration of the new trading ring containing all the state of art features. Dissemination of two-way quotes, company & stock exchange announcements, indicative transaction prices, etc. in respect of all specified scrips and about 800 active non-specified scrips are provided for through the DIDS (Display Information Driver System) on display devices located in the new trading ring and at other vantage points in the exchange complex. This information will soon become available not only in the rest of the country but throughout the world.

Phase II is expected to be operational during the second half of 1993. It will establish a network connecting individual members' offices with the Exchanges' settlement computer 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 requirements, and
- reconciliation facility for unmatched transactions.

Information captured in Phase I would be available to members through the network in Phase II.

Phase III to be introduced in the last quarter of 1994 will provide for an automated trading system covering all scrips except those in the specified group. 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 by the middle of 1995 will extend the coverage of the automated trading system to the scrips in the specified group.

Tandem Computers Inc., U.S.A. have already been commissioned to provide for the requisite hardware for Phases III and IV while the software will be developed by CMC Ltd. of India.

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

NATIONAL STOCK MARKET SYSTEM

National Stock Market System (NSMS) is a system designed basically to provide, in the normal course, an opportunity for an investor in any part of the country where NSMS facilities are available, to trade at the prevailing best market price in any qualified security, through an eligible member of the NSMS Exchange, and subsequently clear and settle the trade in a timely and efficient manner. It is proposed to develop such a system in India in the near future on the lines of the National Market System in the United States. The Stock Exchanges of Bombay Calcutta, Delhi, Madras and Ahmedabad have jointly authorised Arthur Andersen & Associates, an international group of consultants, to draw up a blue print in this behalf.

INDEX MOVEMENTS

Indian stock markets, which virtually remained stagnant in the sixties and rose only by about 60 per cent in the seventies, performed exceptionally well from the beginning of eighties and the trend has continued during the nineties.

The Bombay Stock Exchange Sensitive Index (1978-79=100) which is the major price index based on 30 pivotal scrips listed on the Bombay Stock Exchange gained 507.49 per cent in eighties and during the year 1991-92 recorded an increase of 266.88 per cent. This index recorded its all time peak level of 4467.32 on the 22nd April, 1992 before receding to lower levels subsequently mainly because of shake-up of investor confidence following revelations of large scale manipulations and fraudulent practices in money market instruments. Its present level of around 2700 by itself shows the long-term strength of the market.

Annexures IV give the yearly index values in respect of the BSE Sensitive Index.

PRICE-EARNINGS RATIOS

Price-Earnings ratios of the 30 scrips comprising the BSE Sensitive Index also rose from 17.62 in 1989 to 36.18 in 1992. Annexure V gives the monthly average P/E ratios for the BSE Sensitive Index.

RESILIENCE 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 the stock exchange authorities from time to tune. As per a study conducted by the Bombay Stock Exchange, the average annual fluctuations in the All India index number of security prices of ordinary shares compiled by the Reserve Bank of India was only 25.0 per cent during the period 1980 to 1989 which was on par with the corresponding figures of 23.8 per cent of the London Stock Exchange and 25.2 per cent of the New York Stock Exchange and well below the average of 31.2 per cent of 15 leading countries of the world. The years 1990, 1991 and 1992 have, however, proved to be quite volatile with the average annual fluctuations being of the order of 56.2, 55.9 and 67.4 per cent respectively as against the global averages of 32.9, 27.6 and 24.8 per cent respectively.

INVESTOR PROTECTION

With a view to protecting the interests of investors, the Stock Exchanges in India have set up special cells to deal with complaints both against listed companies and their members. Over 10,000 complaints are looked into every month by the Bombay Stock Exchange alone. While all possible attempts to resolve the grievances are made administratively, disciplinary action of suspending dealings in the securities of companies are also resorted. So far as stockbrokers are concerned, disputes which are not resolved administratively are referred to a well groomed system of arbitration. In case of defaults of stockbrokers, recourse to Customers' Protection Funds set up by stock exchanges is also made. The Bombay Stock Exchange had set up in October, 1986 a Customers' Protection Fund on the lines of the Securities Investor Protection Corporation of the U.S.A. The fund is financed by way of (i) a levy on the turnover of members collected at the rate of one rupee on every Rs.1 million, (ii) levy on the listing fees collected at the rate of two per cent, and (iii) contribution to the extent of 50 per cent from interest realisation from the deposits received from companies raising fresh capital from the existing shareholders by way of rights or from the public through prospectus collected at the rate of one per cent of the issue amount. The Fund had Rs.4.89 million to its credit as at the year ended the 31st December, 1992 after having distributed Rs.1.48 million to the clients of defaulter members of the Exchange. The Fund is being administered only for the benefit of clients of 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.40,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the Fund.

SECURITIES AND EXCHANGE BOARD OF INDIA

The burgeoning growth of the Indian stock markets during the decade of eighties necessitated establishment of an independent regulatory agency for the securities industry. Accordingly, the Securities and Exchange Board of India was established on the 12th April, 1988. The Board was given the statutory status through an Ordinance promulgated by the President of India on the 31st January, 1992 which was later replaced by an Act of Parliament on the 4th April, 1992.

The main objectives of SEBI are to protect the interest of the investors and regulate and promote the development of capital market. SEBI aims to create a systematic environment which would facilitate mobilisation of adequate resources through the securities market, its efficient allocation and consequently generate everlasting confidence of investors and industry in the capital market.

In accomplishing these objectives, SEBI would be responsive to the needs of the three major groups viz., (1) the investors, (ii)companies raising finance and primary market intermediaries, and (iii) the stock market brokers and intemediaries.

To the investors, it whould provide a high degree of protection of their rights and interests, through adequate, accurate and authentic information and disclosure of such information on a continuous basis. The market should be efficient but above all transparent and fair to the investors.

To the companies raising finance and primary market intermediaries, it should afford a market place in which they can confidently look forward to raising all the finance they need in an open, fair and efficient manner.

To the stock markets and brokers, it should offer a competitive, professionalised, transparent and expanding market with adequate and efficient infrastructure so that they are able to render better and responsible service to the investors and issuers.

SEBI initiated its activities with authorisation and registration of merchant bankers in April 1990 to ensure proper and adequate disclosures by companies coming out with new issues as well as to oversee and ensure timely completion of all issue formalties by the concerned companies and other associated agencies. SEBI has introduced penalty points to regulate the merchant bankers and to ensure that they work with due deligence.

SEBI has also insisted upon compliance with

Section 56 (3) of the Companies Act by the issuers by ensuring that an abridged prospectus is issued alongwith the application form so that investors are furnished with proper disclosure of information relating to prospects of their investment.

A major achievement of SEBI is the introduction of a new instrument called Stock Invest which grants to the investors investing in new issues to get returns on their investments till allotment.

After the passage of SEBI Act, 1992, SEBI initiated registration of market intermediaries such as stockbrokers, sub-brokers and spot dealers in securities. In order to ensure that only registered stockbrokers and other intermediaries can function in the secondary market. SEBI also called for registration of other intermediaries such as registrars and share transfer agents, debenture trustees, bankers to the issue, under writers, portfolio managers and investment advisors. SEBI received the following number of applications from different intermediaries.

Brokers	: 5,300
Sub-brokers	:10,500
Non-member brokers	:10,000
Registrars and share transfer agents category (I)	: 323
Registrars and share transfer agents category (I)	: 78
Debenture Trustees	: 41
Bankers to the issue	: 43
Underwriters	: 110

Portfolio Managers	:	418
Investment Advisers	:	542

With the abolition of the office of the Controller of Capital Issues, prior approval of capital issue proposals by companies has been dispensed with. Companies are now required to be fair and honest to the investing public by disclosing all material facts along with the risk factors associated with their projects to the public. Ther merchant bankers authorised by SEBI henceforth have a greater degree of responsibility towards the investors so far as pricing of issues, and disclosures in the prospectus or letter of offer are concerned. In this connection, SEBI has issued Disclosure and Investor Protection Guidelines specifying norms to be followed by the companies issuing capital in the primary market.

SEBI has also issued rules and regulations regarding stockbrokers and sub-brokers. It has also issued rules and regulations relating to Merchant bankers, Mutual funds, Portfolio Managers and Insider Dealing.

SEBI has also taken up the question of re-organisation of governinging boards of stock exchanges and prescription of capital adequacy norms for members to stock exchanges.

SEBI has also been entrusted with authorisation of foreign institutional investors. So far 12 FIIs have been given permission to invest in the secondary market. SEBI also regulates mutual funds operations and in tune with Government policy has recently given permission to six private sector mutual funds besides the public sector mutual funds which are already in existence.

INVESTMENT OPPORTUNITIES FOR OVERSEAS INVESTORS

Foreign investment in the Indian stock markets is subject to well defined and comprehensive provisions embodied in the Foreign Exchange Regulation Act (FERA) of 1973. Direct foreign investment is now allowed upto 51 per cent of the equity in identified high priortiy areas generally known as Appendix I industries. Approvals for greenfield projects in these areas will be given if the foreign equity stake is large enough to cover the foreign exchange requirements for capital goods. There is now no dividend balancing condition for foreign investment proposals in greenfield projects, unless they happen to be for the manufacture of consumer goods in which case they have to balance their dividend payments with their export earnings over a period of 7 years from the date of commencement of commercial production. The dividend balancing condition will not apply to any investments made by international development finance organisations like the International Finance Corporation, the Commonwealth Development Finance Corporation, the Asian Development Bank and the German Development Bank (DEG).

Foreign individuals are not allowed direct portfolio investment in the Indian stock markets. However, they can invest through the intermediation of offshore mutual funds and foreign institutions such as pension funds, mutual funds, investment trusts, asset management companies, nominee companies and incorporated/ institutional portfolio managers or their powers of attorney holders after these foreign insitutions register with the SEBI and the Reserve Bank of India (RBI) and also comply with certain guidelines. Portfolio investment in primary or secondary markets will be subject to a ceiling of 24 per cent of issued share capital for the total holdings of all registered foreign institutions in any one company. The ceiling would apply to all holdings taking into account the conversions out of the fully and partly convertible debentures issued by the company. The ceiling of 24 per cent is inclusive of the holdings of non-resident Indians. The holding of a single foreign institution in any company would also be subject to a ceiling of 5 per cent of total issued capital. For this purpose, the holdings of a foreign institutional group will be counted as holdings of a single foreign institution. These institutions will be taxed at a flat rate of 20 per cent on dividend and interest income and at 10 per cent on long-term capital gains (one year or more). The tax on short-term capital gains which was 65 per cent, has been slashed down to 30 per cent in the 1993-94 Budget. So far 22 foreign institutional investors have been registered to operate in the Indian stock markets.

OFFSHORE MUTUAL FUNDS

In the earlier years when direct foreign investment was not permitted except for the investment by non-resident Indian or through collaboration arrangements for others, a via media was 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 in 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 mobilized U.S. $60 million. In 1989, the State Bank of India launched a privately placed mutual fund "India Magnum Fund" in Antillies, Netherlands. Following an overwhelming response, the fund was closed at $156 million. In 1990, Canbank floated the Himalayan Fund for $ 100 million. Several others are being structured by various institutions to cater to different types of investors. Agencies such as the 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.

The tax on dividends of offshore mutual funds has been reduced by the Finance Act, 1991 from 25 per cent to 10 per cent. Likewise, the tax on long-term capital gains has also been reduced from 45.5 per cent to 10 per cent.

EURO ISSUES BY INDIAN COMPANIES

The Government of India has now permitted Indian companies with a good track record to tap international markets for the capital requirements. Reliance Industries was the first Indian company to make an international capital issue aggregating to $175 million followed by Grasim Industries towards the end of 1992. Several other Indian companies viz., Tata Iron and Steel Co., Essar Gujarat Ltd., Videocon International Ltd., Larsen & Toubro Ltd., Indian Rayon Ltd., Ballarpur Industries Ltd., Southern Petrochemical Industries, CESC, Indian Petrochemicals Ltd., ITC Ltd., Ltd., Hindalco Ltd., Industrial Credit and Investment Corporation of India Ltd. and Shipping Credit and Investment Corportion of India Ltd. have also declared their intention to tap the international market for their capital requirements with some of them even having taken Government clearance for the same. Dividends and long-term capital gains in respect of these investments are taxed at 10 per cent.

NON-RESIDENT INDIAN INVESTMENT

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 predominatly owned (atleast 60 per cent) by the non-resident

Indians. The facilities available for investment for non-resident Indian investments include the following:

(i) Investment in new issues of companies on full repatriation basis is allowed upto 40 per cent of the new issues of equity and preference capital of the new or existing company raising a public issue through prospectus. This facility is 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 is also permitted upto 40 per cent 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 per cent of the output which is raised to 75 per cent in case of industries reserved for the small scale sector, the extent of investment was permitted to the extent of 74 per cent.

(ii) 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 agricultural/plantation activities and/or real estate business (excluding real estate development of property and construction of houses). Such investments are allowed upto 100 per cent of the issued capital of the investee company.

(iii) Portfolio investment in shares and convertible debentures are also liberalised with full benefits of repatriation provided they are purchased through the stock exchange and 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 per cent of the paid-up capital of a company is imposed on total non-resident Indian investments under the portfolio scheme. There are, however, no limits on investment in non-convertible debentures and Master Shares of the Unit Trust of India.

(iv) Non-resident Indians are allowed to invest on a repatriable basis upto 100 per cent of the equity capital in some key industries detailed in Annexure III to the Statement of Industrial Policy, 1991. NRIs can also invest upto 100 per cent of the equity capital of sick companies on repatriable basis.

TAX CONCESSIONS FOR NRIs

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 accuring 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 per cent has been deducted at source, then the non-resident Indian is not required to file a return.

Although the flow of funds into the Indian stock markets has hitherto been not significant, it is only a question of time for this flow to gather momentum. This is basically because of the ever expanding opportunities for the growth of the Indian industry. The annualised returns on the Bombay Stock Exchange, during the period of fifteen years from September 1977 to September 1992, in dollar terms, were 20.0 per cent as compared to 15.9 per cent of France, 14.7 per cent of U.K., 12.3 per cent of U.S.A and Germany, 9.8 per cent of Japan and 7.8 per cent of Switzerland.

CONCLUSION

The Indian stock markets, which attained a remarkable degree of growth in the last one decade, have still a long way to go. However, with the growing popularity of investment in corporate securities and mutual funds, it is expected that about 25 per cent of the household sector savings have been invested in such assets which is comparable to the flow of savings in such assets in the developed markets. 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, SEBI and above all the Government of India - have, however, an ardous task ahead of them. With sustained efforts on the part of all these, 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.

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INTERNATIONAL COMPARISON

(In million of US Dollar)

Sr. No.	Exchange	Market Value Month-end December, 1992	Turnover during 1992
DEVELOPED MARKETS:			
1.	New York	3877900.0	1757095.5
2.	Tokyo	2254844.1	593780.1
3.	Osaka	1955073.5	143234.8
4.	London	954882.6	1773753.3
EMERGING MARKETS:			
5.	Germany	328692.1	1472081.7
6.	Mexico	138744.6	58797.1
7.	Korea	107661.1	116795.5
8.	Taiwan	100158.3	236683.9
9.	India	85880.0	36260.0
10.	Thailand	57278.3	72116.8

ANNEXURE II

CAPITAL RAISED ON ALL-INDIA BASIS

(Amount in Rs. Million)

Year	Equity	Preference	Debenture	Total
1960	704	78	94	876
1965	681	106	216	1003
1970	637	111	119	867
1971	348	68	43	459
1972	699	102	180	981
1973	918	68	149	1135
1974	1001	71	238	1310
1975	634	49	302	985
1976	553	77	406	1036
1977	764	18	291	1073
1978	588	44	171	803
1979	1010	75	333	1418
1980	909	21	1029	1959
1981	1693	14	1361	3068
1981-82	2431	27	3156	5614
1982-83	2587	23	4450	7060
1983-84	3816	17	4542	8375
1984-85	3629	01	6933	10563
1985-86	8351	10	7982	16343
1986-87	10295	--	17407	27702
1987-88	8100	--	6642	14742
1988-89	11500	--	24000	35500
1989-90	12188	79	52464	64731
1990-91	12857	131	29314	42302
1991-92	17278	15	40199	57492
1992-93 *	--	--	--	180000

* Provisional

CAPITAL RAISED ON ALL-INDIA BASIS

(Amount in US $ Million)

Year	Equity	Preference	Debenture	Total
1960	147.9	16.4	19.8	184.1
1965	142.5	22.2	45.2	209.9
1970	84.0	14.6	15.7	114.3
1971	47.8	9.3	5.9	63.0
1972	86.5	12.6	22.3	121.4
1973	111.9	8.3	18.2	138.4
1974	122.8	8.7	29.2	160.7
1975	76.0	5.9	36.2	118.1
1976	62.3	8.7	45.7	116.7
1977	93.1	2.2	35.4	130.7
1978	71.8	5.4	20.9	98.1
1979	127.7	9.5	42.1	179.3
1980	114.6	2.6	129.8	247.0
1981	186.1	1.5	149.6	337.2
1981-82	267.2	3.0	346.9	617.1
1982-83	268.5	2.4	462.1	733.0
1983-84	363.7	1.6	432.9	798.2
1984-85	291.5	0.1	556.8	848.4
1985-86	686.2	0.8	655.9	1342.9
1986-87	784.6	--	1326.8	2111.4
1987-88	628.9	--	515.7	1144.6
1988-89	769.2	--	1605.4	2374.6
1989-90	715.3	4.6	3078.9	3798.8
1990-91	711.5	7.2	1622.2	2340.9
1991-92	669.4	0.6	1557.5	2227.5
1992-93 *	--	--	--	5762.7

* Provisional

ANNEXURE IV

VOLUME OF TURNOVER - BOMBAY STOCK EXCHANGE

Year	Amount in Rs. billion		Amount in US $ billion	
	Daily	Annual	Daily	Annual
1980-81	0.13	24.76	0.02	3.12
1981-82	0.38	68.51	0.04	7.53
1982-83	0.23	43.57	0.02	4.52
1983-84	0.13	24.88	0.01	2.37
1984-85	0.23	47.96	0.02	3.85
1985-86	0.35	74.29	0.03	6.10
1986-87	0.67	136.91	0.05	10.44
1987-88	0.36	79.13	0.03	6.14
1988-89	0.97	205.63	0.06	13.75
1989-90	1.35	293.86	0.08	17.25
1990-91	1.93	360.12	0.11	19.93
1991-92	3.31	717.77	0.13	27.81
1992-93	2.38	456.96	0.08	14.63

ANNEXURE V

BSE SENSITIVE INDEX (1978-79 = 100)

Year	High	Low	Closing
1979-80	131.59	113.28	128.57
1980-81	173.44	121.50	173.44
1981-82	252.89	172.81	217.71
1982-83	236.62	204.66	211.51
1983-84	255.84	207.17	245.33
1984-85	353.86	233.11	353.86
1985-86	664.57	346.53	574.11
1986-87	658.92	482.41	510.36
1987-88	535.61	390.00	398.37
1988-89	719.07	397.16	713.60
1989-90	798.01	659.30	781.05
1990-91	1559.43	748.79	1167.97
1991-92	4285.00	1191.61	4285.00
1992-93	4467.32	2225.08	2280.52

BSE SENSITIVE INDEX (1978-79 = 100)

(In US $ Terms)

Year	High	Low	Closing
1979-80	132.27	113.84	129.98
1980-81	173.37	121.45	173.37
1981-82	252.84	171.96	217.67
1982-83	207.31	179.31	185.31
1983-84	208.86	169.13	200.28
1984-85	270.63	178.28	270.63
1985-86	443.50	231.26	383.13
1986-87	435.41	318.78	337.25
1987-88	338.58	246.53	251.83
1988-89	376.43	207.91	373.57
1989-90	380.04	313.98	371.96
1990-91	653.78	313.92	489.66
1991-92	1355.20	376.87	1355.20
1992-93	1138.25	566.94	581.06

BSE SENSITIVE INDEX

PRICE EARNINGS RATIO - MONTHLY AVERAGES

Month	1989	1990	1991	1992	1993
January	18.59	15.81	16.79	26.56	30.72
February	18.95	14.39	18.44	31.33	32.93
March	19.09	15.08	19.68	44.32	29.34
April	21.09	16.84	21.09	52.60	27.63
May	19.91	17.76	21.73	42.80	-
June	19.44	16.73	21.52	39.60	-
July	18.09	18.67	23.24	33.97	-
August	15.06	21.31	26.24	33.57	-
September	15.08	23.52	24.75	38.76	-
October	15.06	23.10	23.79	37.35	-
November	14.69	22.30	24.10	32.15	-
December	15.56	19.69	23.98	31.35	-
Average	17.62	19.81	22.31	36.18	30.16

VOLATILITY IN STOCK MARKETS

PERCENTAGE RANGE OF FLUCTUATIONS OF INDEX NUMBERS

SR. NO.	NAME OF THE EXCHANGE	AVERAGE 1989-90	1990	1991	1992	AVERAGE 1990-92
1.	LONDON	23.8	21.3	26.4	20.1	22.6
2.	NEW YORK	25.2	23.7	24.8	8.4	18.9
3.	CANADA	24.4	28.5	13.1	13.7	18.4
4.	AUSTRALIA	34.6	29.7	33.9	21.5	28.3
5.	JAPAN	20.6	62.8	23.4	49.8	45.3
6.	HONGKONG	48.2	26.1	36.1	39.9	34.0
7.	BELGIUM	28.6	28.9	23.3	16.6	22.9
8.	FRANCE	33.5	31.7	24.2	22.9	26.2
9.	GERMANY	25.2	38.9	26.7	24.2	29.9
10.	HOLLAND	33.2	21.9	22.3	12.7	18.9
11.	ITALY	44.8	41.6	24.8	43.4	36.6
12.	SINGAPORE	40.9	39.3	30.7	16.4	28.8
13.	SOUTH AFRICA	31.8	19.5	42.7	17.5	26.5
14.	SWEDEN	38.9	47.9	34.9	45.4	42.7
15.	SWITZERLAND	24.0	31.8	26.3	20.2	26.1
	AVERAGE	31.8	32.9	27.6	24.8	28.4
	BOMBAY (BSE SENSITIVE INDEX)	33.1	81.1	67.2	78.5	75.6
	R. B. I. INDEX (ALL-INDIA) INDUSTRIAL SECURITIES (ORDINARY SHARES)	25.0	56.2	55.9	67.4	59.8