STOCK EXCHANGE DEVELOPMENTS AND REGULATION

M.R. Mayya
## CONTENTS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Page No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Recent Developments in Stock Exchange</td>
<td>1</td>
</tr>
<tr>
<td>2.</td>
<td>Regulation of Stock Markets and Investor Protection</td>
<td>5</td>
</tr>
<tr>
<td>3.</td>
<td>Travails of the Indian Stock Markets</td>
<td>31</td>
</tr>
<tr>
<td>4.</td>
<td>Investor Protection</td>
<td>39</td>
</tr>
<tr>
<td>5.</td>
<td>Recent Trends in Securities Markets</td>
<td>49</td>
</tr>
<tr>
<td>6.</td>
<td>Generating Opportunities for Overseas Investors</td>
<td>59</td>
</tr>
<tr>
<td>7.</td>
<td>NRI Investment in Indian Securities Market</td>
<td>67</td>
</tr>
<tr>
<td>8.</td>
<td>Indian Capital Market During Nineties</td>
<td>77</td>
</tr>
<tr>
<td>9.</td>
<td>Indian Stock Markets</td>
<td>83</td>
</tr>
<tr>
<td>10.</td>
<td>Meeting of FIBV : Suggestions Regarding possible areas of Assistance by FIBV to Emerging Markets</td>
<td>109</td>
</tr>
<tr>
<td>11.</td>
<td>Indian Stock Exchanges : Responsibilities and Authority</td>
<td>113</td>
</tr>
<tr>
<td>12.</td>
<td>Insurance for Capital Market Securities</td>
<td>127</td>
</tr>
<tr>
<td>13.</td>
<td>Rationale for Payment of Contango Charges in Respect of Short Sales</td>
<td>135</td>
</tr>
<tr>
<td>14.</td>
<td>The Bombay Stock Exchange</td>
<td>139</td>
</tr>
<tr>
<td>15.</td>
<td>Organisation and Trading Practices of Indian Stock Exchanges</td>
<td>147</td>
</tr>
</tbody>
</table>
Recent Developments In Stock Exchange

M. R. MAYYA
Executive Director
The Stock Exchange, Bombay

The stock markets of the country have staged a strident advance since the beginning of the 80s. The quantum of capital raised from the new issues market has risen from a meagre annual average of about Rs.90 crores in the 70s to about Rs.4,200 crores in 1986-87. Despite the setback in the current year, about Rs.3,500 crores would be raised during the current year. The daily turnover in the secondary market has shot up from just about Rs.4 crores in all the markets about a decade ago to about Rs.100 crores in 1986-87, although in the current year, it is about Rs.60 crores. The number of shareholders has also risen sharply from just about a million to 10 million during this period, catapulting this country to the position of the third largest shareholding population nation next only to the United States of America and Japan who are currently nursing about 50 million and 22 million shareholders respectively. The number of recognised Stock Exchanges in the country has also increased from a stagnant figure of 8 till 1979 to 15 presently. All these changes have come about not because of a sudden flow of dispassionate love towards industrial securities out of philanthropic approach but out of a cool calculation of returns from investment in these securities vis-a-vis alternate channels of investment. As against an overall negligible rise of just 2 per cent in the index number of ordinary shares over the 60s and of about 60 percent over the 70s, the rise since the beginning of 80s has been about 110 per cent while the rise in the index number of wholesale prices during these periods has been about 80 per cent, 160 per cent and 60 per cent respectively. Equities have thus prove to be more than a hedge against inflation in the 80s.

Despite the sharp growth in the activities of the stock markets, no serious attempt has so far been made to tap the semi-urban and rural areas whose annual saving are at present about Rs.16,000 crores. The four metropolitan cities of Bombay, Delhi, Calcutta and Madras account for nearly 60 per cent of
shareholdings in the country out of which Bombay alone accounts for about 35 per cent. The shareholding population in semi-urban and rural areas is estimated to be not more than 6 per cent. Attempt to lure the investors from semi-urban and rural areas and also cities with a population up to 10 lakhs needs to be stepped up for acceleration of the flow of funds into equities.

Another rich bowl of funds is the non-resident Indians who are estimated to be nourishing over Rs. 1,00,000 crores with an annual accretion of about Rs. 25,000 crores. Despite the several concessions, the flow hitherto has hardly been about Rs. 1,000 crores. Proper education and simplification of procedural formalities are rapidly called for to encourage the flow of these funds into the Indian markets.

In the larger interest of ensuring development of the corporate sector, it is necessary that flow of funds into industrial securities, particularly equities, does not receive any setback. For this purpose, it is absolutely essential to take all precautions against attempts to hammer down prices. Stock Exchange authorities and Financial Institutions have, therefore, to be ever vigilant and take appropriate action from time to time to ensure this. Stock Exchange authorities have numerous weapons like margins, prevention of further dealings, ban on speculative transactions, minimum prices, etc. all or some of which can usefully be deployed to achieve this objective. Financial Institutions who own over 30 per cent of equities can easily support the market by timely purchases in periods of recession. This is, however, not to say that stock prices should be jacked up artificially on a permanent basis.

Innovations are called for with regard to instruments in the primary market. The non-convertible debentures which till recently had proved to be attractive have started fading away. Preference shares have completely melted away from the market. Equities and convertible debentures are the only instruments presently available for mobilisation. There is need to ensure that non-convertible debentures and preference shares are not allowed to vanish. Suitable changes in the terms of these instruments can be made to revive their allurement to the investors. The convertible cumulative preference share which was a non-starter can also be made a potent instrument for mobilisation of resources. Besides other instruments like zero coupon bonds, debentures on tap, warrants, mutual funds with private sector, etc. should be developed to ensure that the investor have a wider spectrum of choice for investment in industrial securities.

While new issues of unknown entrepreneurs without a track record get a lukewarm response, the public response to good issues by established houses continues to be excellent. On an average, equity issues were oversubscribed about seven times in 1984-85 and eight times in 1985-86 on the Bombay Stock Exchange with several of them being over-subscribed more than twenty times. Heavy-over-subscription is a rational waste and ways and means will have to be found out to prevent such a waste. Evolution of tender system, restricting the number of centres for collection of application money and keeping the subscription list open for only one day could be some of the measures that could be considered in this behalf.

A major malady of the new issues market is the unofficial market where premium rates are rigged up by the promoters, underwriters, brokers and others interested in making the new issues a success. These premium rates not only disappear after the enlistment but the shares are either not traded at all or are quoted with a discount. The dealings in this market should, therefore, be curbed totally so that the gullible investing public do not
that the gullible investing public do not get misled. Alternatively, this market can be regulated after the prospectus of a company are filed with the Registrar of Companies on an "as and when issued basis" as in some of the developed countries of the world.

Innovations are called for in the secondary market too. The sharp increase in turnover has not generated the required liquidity. Out of the securities of about 5,000 companies listed on the stock markets, hardly 50 per cent of them get traded in a year. 122 shares in the specified group (in which contracts need not necessarily result in delivery as in the non-specified group; they can be offset by opposite contracts or carried forward from one settlement period of 14 days to another) in the four major Stock Exchanges of Bombay, Calcutta, Delhi and Ahmedabad account for 80 per cent of the trading and even out of this, about 25 shares account for 75 per cent of the turnover. In other words, 60 per cent of the turnover in the market is confined to about 25 shares.

The question of appointing specialists or market makers in all the listed securities who will always give a give-two quotation, as in some of the developed countries, merits serious consideration. Such specialists or market makers must be offered securities by the issuer on the same terms at which the offer is made to the public. They should also be given liberal financial support from commercial banks. Listing of a security on a Stock Exchange only then has a real meaning. It is heartening to observe in this connection that it has recently been decided by the Presidents of Stock Exchanges to insist on a sponsoring broker for a company with an issued capital of Rs.3 croros or more seeking enlistment on Stock Exchanges and more importantly for the sponsoring broker to act subsequently as a market maker. The translation of this decision into practice will be watched with interest.

There is a growing tendency for business to be concentrated in Bombay which today accounts for about 70 per cent of the turnover in the country. This is not conducive for allround development of the securities industry in the country.

One possible way to arrest this concentration is to structure a national market through electronic devices on the lines of the National Market System in USA which has linked up all the seven leading Stock Exchanges in that country and which enables an investor sitting in one market buy at the cheapest possible price prevailing in any other market and sell at the dearest possible price ruling in any other market. While we may take a few years to structure such a market in the country, a beginning has already been made by linking up electronically all the major Stock Exchanges in the country for the purpose of simultaneous display of prices and other related information through the PTT Stockscan Scheme. This will not only lead to increased arbitrage business among different markets but also the development of nofussi markets as they are no longer be required to wait for Bombay quotations which set the pace of the stock market operations in the country. We should also plan to extend the pattern of trading in specified shares prevalent in major Stock Exchanges to minor Stock Exchanges also subject, of course, to proper checks and balances. This will naturally increase the liquidity in the minor Stock Exchanges.

Another major area that needs immediate attention is the odd lots which have proved to be a bug bear for the investors who normally receive 15% to 20% less than the prevailing market price for sale and have to pay 15% to 20% more than the ruling market price for purchase. The Bombay Stock Exchange has recently not only appointed 16 members of the Exchange as authorised dealers in odd lots but also set norms for their operations. The discount for the sale of odd lots cannot exceed 10% if the price of the share is
upto Rs.40, 7 1/2% for shares of the price from Rs.40 to Rs.100, 5% for shares from Rs.100 to Rs.300 and 5% or less for shares above Rs.300. A special trading session for one hour in a week has also been organised by the Exchange to facilitate trading among the members. The scheme has met with resounding success and deserves to be emulated by other Stock Exchanges.

While the above measures are no doubt welcome, companies should also appoint trustees who should buy these odd lots on a regular basis and give to the investors the net proceeds after deducting the expenses involved in consolidation and disposal. Companies Act, 1956 can also be amended to permit companies themselves to buy these shares, as in U.K. and U.S.A.

Insider trading is one of the menaces raging the Indian stock markets. While insider trading is prohibited in almost all the countries of the world, with strict penal provisions for violations, it is indeed sad to note that neither the Companies Act, 1956 nor the Securities Contracts (Regulation) Act, 1956 contains any punitive provisions against insider trading. The Government should hasten legislation in this regard, preferably by an ordinance.

Restrictions on the currency of the transfer deed to a period of two months or till the next book-closure, whichever is later, have acted as a hindrance to the spread of equity cult in the country, particularly into the semi-urban and rural areas and among the NRIs. The proposal contained in the Companies Amendment (Bill), 1987 to extend the period of two months to twelve months is welcome, but by itself. These restrictions need to be done away with to ensure free liquidity and transferability of shares. Besides attempts to immobilise movement of securities by establishment of Stock Holding Corporations on the lines of Depository Trust Corporations in the USA, should be made on a priority basis. Ultimately we should plan to journey towards a certificate/less society as is being planned by U.K. Late Mr. P.J. Jejeebhoy, Chairman of the Bombay Stock Exchange, had submitted a blueprint in this behalf way back in 1979. A High-Powered Committee may be appointed to exclusively look into these problems and come to an early conclusion from a totally objective angle sans inhibitions and shibboleths.

Confidence of investors can be sustained if only it is ensured that the securities they give to the stock brokers for sale and the money they deposit with the stockbrokers for purchase do not get willed away by their default. The Customers Protection Fund established by the Bombay Stock Exchange in October, 1986 guaranteeing to each investor an amount of Rs.10,000 in respect of his genuine investment claims in case of a default by a member of the Exchange is a significant step towards this end. The amount of Rs.10,000, however, needs to be raised to a much higher level, in fact, ultimately, to the total amount of claims.

All these and several other measures are called for if the Indian Stock Exchanges have really to prove to be citadels of shareholders' democracy in this country.

Regulation of Stock Markets and Investor Protection

by

Mr. M.R. Mayya
Executive Director,

The Stock Exchange,
Bombay

Proper regulation of the market and due protection of the investors are the sine qua non of a healthy functioning of a Stock Exchange anywhere in the world at any point of time. Control and regulation over the functioning of Stock Exchanges have come only when either the markets have not been regulated properly or the interests of the investors were affected adversely. The Great Crash of the Black Thursday, the 29th October, 1929 in the U.S.A. resulted in the enactments of the Securities Act of 1933 and the Securities Exchange Act of 1934. A far more severe crash of Thursday, the 19th October, 1987, is bound to lead to tightening of controls and regulations and several investigations into the causes of the debacle are already on. Even in our own country, it was that which led to the initial regulation of the Stock Exchanges in the erstwhile State of Bombay by placing the
Bombay Securities Control Act of 1925 on the statute. This was subsequently followed by the Securities Contracts (Regulation) Act of 1956 of the Union Government with the subject of Stock Exchanges being included in the Union List in the Constitution of India and the frontiers of regulation being extended to the whole country.

Two-tier Layer of Regulation

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

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

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

Listed Companies

Companies seeking enlistment of securities on Stock Exchanges have to comply with a very strict schedule of listing requirements beginning from the requirement of public offer till the execution of Listing Agreement comprising 41 clauses. The Agreement is in the form of a covenant designed to facilitate smooth and orderly trading in the market and to protect the interests of shareholders and others who invest or deal in securities. The Agreement, inter alia, provides for prompt transfer, registration, sub-division and consolidation of securities into market lots without any special charges, notifying the Stock Exchanges immediately about the total turnover, gross and net profits, appropriations including dividend distribution, increase of capital by issue of right or bonus shares, any proposed change in the general character and nature of business etc., submission of annual reports, notices and circulars sent to shareholders, annual schedules showing the distribution of securities etc., publication of half-yearly reports about the working and
earnings of the company, offer of right issues to the shareholders together with the right of renunciation to be accepted/recorded within a reasonable time, not being less than four weeks, payment of dividend warrants/payable at par at certain specified centres, comparable offer to the minority shareholders whenever somebody secures the effective control of the management of a company or acquires 25% or more of the voting capital of the company at a price not lower than the price at which the shares of the company have been acquired, etc. With a view to ensuring that a listed company does not act in a flippant manner, the Agreement also ordains that the company, unless the Stock Exchanges agree otherwise, will not without the previous permission of the Central Government withdraw its adherence to the Agreement.

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

**Control and Regulation over Trading**

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

Excessive speculation can and does cause wide and sharp fluctuations in prices to the detriment of the market as a whole while defaults shake the very foundation of the functioning of the Stock Exchange. It is, however, rather difficult to assess in precise terms as to what is the desirable degree of speculation and what is not. Any quantitative approach like the proportion of deliveries to the volume of trading or of the extent of fluctuations to the turnover can be exercises in futility.
Paradoxical as it may appear, generally a larger volume is accompanied by a narrower range of price fluctuations. It is precisely because of this that the movement of prices on the Bombay Stock Exchange, which accounts for about two-thirds of the business of the country, is more orderly with oscillations being confined to a narrower groove, as compared to other Exchanges. Nonetheless, it is absolutely necessary to curb excessive speculation, both on the bullish and bearish sides and what is more important, in time, and at times a qualitative approach like the feel of a situation may be more useful in arriving at a conclusion in the matter. This is not to say that the various monitoring mechanisms evolved to constantly gauge the market activities are not helpful. In fact, at the Bombay Stock Exchange daily reports of operators having outstanding business above 0.5 per cent of the paid up capital of a company and of the major ten operators, five on the purchase side and five on the sale side, in a scrip whose outstanding position is above 2.5 per cent of the paid up capital of any company are, among other things, being constantly monitored and these have proved to be extremely helpful in tracking down speculative activities.

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

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

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

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

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

**Margins**

Three types of margins are deployed to regulate the market. First, daily margins are collected in respect of every contract outstanding at the end of the day. These are normally payable in about 30 to 35 scrips out of the total of seventy scrips in the specified group. Rates of margins vary from about 10% to 25% in respect of about 15 volatile scrips and 5% to 10% with regard to others. In a rising market, bears pay at about 50% of the rates payable by bulls and the position is reversed in a falling market. The higher rates against bulls in a rising market and against bears in a falling market are recognised as a price corrective measure dissuading
the bulls from purchases when the market is buoyant and the bears from sales when the market is depressed. There is no fixity about these rates and are often changed to be in tune with the constantly changing market situation. Calling for stability in these rates, as is being done by a section, is displaying ignorance of the objective of the margin requirement.

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

The second type of margin is the carry-over margin payable by members on the aggregate of the net balance of purchases and of sales carried over from one settlement to another on account of each of their clients and on their own account as principals, in all the specified shares, irrespective of whether or not daily margins have been made applicable to these shares. While the minimum rate of carry-over margin is 3% of the making-up price i.e. the price at which the
transactions are carried over from one settlement to another, generally it is about 5% to 25%. As in the case of daily margin, the rate of carry over margin is higher in respect of purchases in a rising market and in respect of sales in a falling market. In fact, a part of the profit is always impounded, the attempt thus being to use this weapon also as a price corrective measure. As far as possible the rate of carry over margin is not pegged below the daily margin rate. While calculating the carry over margin the daily margin already paid, however, gets subsumed.

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

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

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

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

There is a tendency to confuse our system of margins with margin trading in the U.S.A. In the U.S.A., a stock bought must result within five business days in taking of delivery and full payment for the same has to be made. There is no provision for carry-over as in India. The investor has the facility of paying cash upto
the stipulated extent which is set by the Federal Reserve Board and which is at present 50% and the balance 50% is paid by the broker through a "broker loan" obtained from a bank and collateralized by the purchased stock. Thus full payment is made for the stock purchased while in India, differences are settled between the contract rate and the settlement price (technically called the making-up price) fixed by the Stock Exchange authorities on the last day of the settlement period on the basis of the closing prices of the day. The margin money required to be collected here is a cover against the likely adverse movement of prices while the margin money in the U.S.A. is the amount funded by banks into the security industry and there just cannot be any comparison between the two. Yet it is strange that this is being done, even by the erudite.

**Limits on Business**

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

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

**Prohibition of further Dealings**

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

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

**Floor and Ceiling Prices**

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

Following a sharp decline in prices in November, 1986, the Bombay Stock Exchange authorities had fixed the closing prices on 30th November, 1986 as the
floor prices and these were operating from the 1st December, 1986 to 19th December, 1986 when the prices started recovering and were quoted above the floor levels.

Prohibition on Speculative Transactions

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

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

Trading on account.

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

**Band of Limits**

Part and parcel of trading on account recommended by the Dave Committee was introduction of the concept of band of limits on movement of security prices to reduce the hazards involved in sharp fluctuations and make the movement more orderly and evenly. Limits were imposed not only on the daily two-way movements in prices as compared to the previous day’s closing quotation, but also on the extent of fall or rise during a settlement period in relation to the making-up price of the previous settlement period as under:
<table>
<thead>
<tr>
<th>Market price of the share</th>
<th>Daily limit of price fall or price rise</th>
<th>Settlement period limit of price fall or price rise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto Rs. 50</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>Above Rs. 50 upto 100</td>
<td>7.5%</td>
<td>15%</td>
</tr>
<tr>
<td>Above Rs. 100</td>
<td>5%</td>
<td>10%</td>
</tr>
</tbody>
</table>

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

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

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

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

It is rather premature to pass any value judgement on the efficiency of the price bands as an instrument for regulation of the market. Yet the fact that once the limits are reached an operator is denied the right to cut short his losses which might
result in his inability to meet the market liability subsequently is a factor which needs consideration.

**Closure of the Market**

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

**Regulation of Cash Market**

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

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

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

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

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

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

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

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

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

The Investors' Service Cell tries its level best to redress the grievances as expeditiously as possible. In fact, in all the communications to the investors they are requested to contact the cell if their grievances are not redressed within a reasonable time, thereby clearly indicating to them the earnestness of the Cell to
resolve the problems of the investors. Out of the 21,169 complaints received by the cell in 1987, 16,557 complaints were disposed of.

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

**Arbitration**

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

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

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

Customers' Protection Fund

Whenever a member of a Stock Exchange is declared as defaulter, the net assets remaining in the hands of the Defaults' Committee after defraying costs, charges and expenses relating to the realisation of these assets are utilised to satisfy first the claims of the Exchange and the clearing House run by the Exchange and then the admitted claims of members of the Exchange against the defaulter on a prorata basis. Only if any surplus is left thereafter, the claims of the clients of a defaulter member are considered by the Defaults' committee. The clients can, no doubt, go in for arbitration with the Exchange in respect of their claims and obtain awards in their favour and thereafter get the same filed in a Court of Law for decree. The decrees, however, cannot generally be executed as the defaulter invariably disposes of all assets before he is declared a defaulter.
Lack of suitable protection to the clients in the event of a member of a Stock Exchange being declared a defaulter has proved to be a major bottleneck in the flow of funds into industrial securities. Ministry of Finance had, therefore, directed the Stock Exchanges of the country to set up a Customers’ Protection Fund. The Bombay Stock Exchange was the first to set up such a Fund. Established in October, 1986, the Customers’ Protection Fund of the Exchange is patterned on the lines of the Securities Investor Protection Corporation of the U.S.A. and the Stock Exchange Compensation Fund of the London Stock Exchange. The fund is financed partly by way of a levy on the turnover of members collected at the rate of one rupee for every Rs. 10 lakhs and partly by way of contribution from the listing fees collected at the rate of one per cent. The Fund has at present about Rs. 3 lakhs to its credit. The Fund is being administered only for the benefit of the clients of the defaulting members of the Exchange and their beneficiaries in respect of genuine investment claims. The compensation that may be paid in respect of any single client is limited to Rs. 10,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the Fund. While there is no ceiling on the amount of compensation that may be paid from the Compensation Fund of the London Stock Exchange, the Securities Investor Protection Corporation of the USA limits the payment to a single customer to $5,00,000 out of which claims on cash, as distinct from claims for securities, would not be more than $1,00,000. The Securities Investor Protection Corporation has a line of credit up to $500 million from the banks, besides $ 1 billion from the Securities and Exchange Commission which in turn can borrow the same from the U.S. Treasury. A similar dispensation in this country can help in grant of increased compensation from the Customers’ Protection Fund.

Odd Lots

Odd lots constitute a major constraint of the Indian investors. Out of a total market capitalisation of about Rs.25,000 crores equities worth about Rs.4,000 crores are in odd lots. About 70% of the holdings of a leading company are in odd lots. Investors normally receive 15% to 20% less than the market price for
their sales and have to pay 15% to 25% more than the market price for their purchases of odd lots. Schemes evolved by some of the agencies and companies to fetch a better price for the investors have not proved to be much of a success.

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

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

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

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

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

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

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

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

Offer to Non-Management Shareholders

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

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

Insider Trading

Insider trading i.e. trading in securities by persons in possession of material
non-public information relating to such securities, which is price-sensitive,
strangely remains totally uncontrolled and has proved to be one of the biggest
menaces to the investors. The limited provision contained in Section 307 of the
Companies Act requiring shareholdings and debentureholdings of directors to
be recorded and kept open for inspection of any shareholder or debentureholder
during the period of 14 days before and 3 days after the Annual General Meeting
of a company has proved to be totally ineffective is controlling such trading.
Publication of half-yearly results by listed companies as required by clause 41
of the Listing Agreement in operation from the beginning of last year has also
not minimised such trading. Not only insider trading needs to be prohibited
with provision for deterrent punishment for offenders under a suitable
statutory framework but also enforced strictly and rigidly. Till such time Government comes out with the legislation, it behoves stockbrokers as trustees of public welfare not to put in transactions of “Insiders” if they realise that these are based on non-public information.

## Conclusion

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

TRAVAILS OF THE INDIAN STOCK MARKETS

M.R. Mayya
Executive Director
The Stock Exchange, Bombay

Never in the history of the stock markets of this country have so many changes taken place so fast as at present, transforming virtually a dormant instrument into a vital and vibrant weapon for garnering the savings of the nation into fruitful and constructive channels. Even taking parallels of other countries, one can only think of the changes that preceded the Big Bang in U.K. in October, 1986 - dismantling the Chinese wall between jobbers and dealers, removing the minimum commission rates, permitting commercial banks to enter into investment banking, etc. - as a comparable phenomenon, and no others and that too with a difference, a vital one at that. The latter were planned and deliberated upon for a long time before being given effect to, while in the case of the former, the changes have come about all too suddenly, with all the resultant problems attendant thereon. It is like an airport, to put in a layman's language, designed for dakotas, being suddenly called upon to handle jumbos. The herculean efforts being put in by all concerned, particularly the Stock Exchange authorities, to restructure the airport for soft landing and brisk taking off of the jumbos, have not been appreciated fully. On the contrary, slight dislocations here and there caused by such a radical transformation are looked into through magnified glasses and criticised out of proportion to the extent of dislocation. This should not, however, dishearten the authorities from carrying on their task, howsoever, gigantic that be.

Causes of Changes

The changes that have occurred in the stock markets are a true and direct reflection of the changes in the governmental policies, basically in fiscal and industrial matters, titillating private enterprise and initiative to contribute to the growth of economic prosperity of the nation. As a result, equities which acted as a poor hedge against inflation right till the seventies, changed their role from the beginning of the eighties, alluring investors to divert their savings into the corporate sector. As against an overall negligible rise of just 2 per cent in the index number of ordinary shares over the sixties and of about 50 per cent over the seventies, the rise since the beginning of the eighties has been 175 per cent while the rise in the index number of wholesale prices during these periods has been about 80 per cent, 160 per cent and 70 per cent respectively.

Extent of Growth

The extent of growth can easily be gauged by the fact that as against an annual average amount of just Rs. 90 crores raised from the new issues market in the seventies, about Rs. 5,000 crores were raised in 1986-87 and an equal amount is expected to be raised in the current year. The daily turnover on the Bombay Stock Exchange alone has shot up from a meagre amount of about Rs. 4 crores about a decade ago to about Rs. 100 crores in 1986-87 and over Rs. 125 crores at present. The number of shareholders has also risen sharply from about a million to about 10 million during this period, catapulting this nation to the position of being the second largest shareholding population nation in the world, next only to the United States of America, which is currently nursing about 50 million shareholders. Market capitalisation has also registered a more than tenfold rise from about Rs. 3,500 crores to over Rs. 35,000 crores during the last one decade, accounting for about 12 per cent of the GNP now as against about 3 per cent ten years ago.

The more than ten-fold growth in a decade measured by any standard has naturally resulted in the stock markets becoming the cynosure of all eyes - entrepreneurs for capital, public for investment and Government for regulation - with the ever vigilant press of the country acting as the watch-dog. Naturally, the global eyes too are on this market, as it is a major market in the emerging markets of the world and bigger than some of the markets in the developed countries of the world.

Welcome as the growth of the markets is, the suddenness and fastness of the same, have in its trailled to several problems, some of which are proposed to be discussed here.
Lack of Accommodation

The travel from the shadows of trees where stockbrokers assembled in the initial stages of establishment of Stock Exchanges to the modern air-conditioned mansions has no doubt been exciting and enchanting but what is disheartening and disillusioning is the constraint to share the accommodation in the new habitat with the financial institutions due to lack of resources with the Stock Exchanges and the stock brokers. This is so not only at the Bombay Stock Exchange but at almost all other Stock Exchanges in the country. This, in turn, has stifled the growth of Stock Exchanges, resulting in a hunt for new accommodation, acquisition of which is again constrained by lack of finance. The vicious circle can be broken only if the financial institutions adopt a more understanding attitude and shift their offices from Stock Exchange premises. In the larger interest of preventing the securities industry - the mother of all industries - from turning sick, financial institutions will also have to grant liberal loan facilities without any claim on accommodation. Grant of loans to the extent of say Rs. 10 crores a year for a period of five years will solve this problem once for ever. A pragmatic approach on these lines will help greatly in dispelling the concept among some that Stock Exchanges are the private properties of stockbrokers. Stock Exchanges belong to the community at large.

Growth of Membership

Growth in the membership of the Exchange is not at all commensurate with the growth of the securities industry. As against the more than ten-fold increase in the growth of the securities industry, the strength of active membership of Stock Exchanges has just doubled to about 2,500 in the last one decade. This has naturally led to a deterioration in the services to the investors. Increase in the membership of Stock Exchanges is, therefore, a must. A mere quantitative approach, however, cannot solve this problem. Stockbroking houses should grow into larger ones, using better resources and individual stockbrokers should amalgamate themselves into firms and companies so as to be able to penetrate into the four corners of the country. The London Stock Exchange has at present only about 360 operating entities although it has about 5,300 individual members. Similar is the case with the New York Stock Exchange with about 600 member organisations as against about 1450 members. Not many members seem to be willing to take advantage of the recent dispensation permitting companies with unlimited liability to become members of Stock Exchanges. This can lead to financial institutions and their subsidiaries and subsidiaries of commercial banks who are also permitted to become members of Stock Exchanges, making deep inroads into the field wholly reserved hitherto for the stockbroking community, to the chagrin of the latter. Perforce, the stockbrokers have to attune themselves into the new outfit for survival.

Restructuring Governing Boards

Governing boards of Stock Exchanges in almost all countries of the world today are no longer the exclusive domain of stockbrokers. Representatives of government and public, besides professionals, have slowly entered these boards, mostly as a result of reluctance on the part of the stockbroking community to mould themselves to the ethos of changing times. Even the traditional London Stock Exchange which is one of the best managed Stock Exchanges in the world, had to give way in this regard. It is true that this country is not lagging behind, although the dialogue with regard to the extent of representation of the non-brokers, is still on. It is not just the number but the quality of the non-broker directors that matters. Even one of them can sway the deliberations. Choosing the right type of non-broker director having the requisite degree of integrity and independence and imbued only by public interest is certainly not an easy task.

Administration

Equally important is the development of an able and impartial administration to run the Stock Exchanges. Selection of the right type of person to the post of Chief Executive, who can withstand the growing pressures from the mighty corporate world on the one hand and the fast growing securities industry on the other, has really proved to be a difficult proposition. More difficult has been the task of building up all too suddenly a team of dedicated officers well versed in the intricacies of Stock Exchange operations to man the growing secretariat of the Exchanges. Ensuring that the officers do not get influenced by continuous exposure to swift movements of wealth has been a still more difficult task.
New Issues Market

Resurgence in the secondary market has already started having its reflections on the primary market, with most of the public issues evoking good response. The link between the primary market and the secondary market, however, appears at times to be over stretched. Even in the acute bear phase of last two years, there have been a number of good issues by the lesser known enterprises which elicited favourable response. With the Indian investor getting progressively better educated, albeit the hard way, he is much more discerning today than in 1985-86, and it is quite unlikely that the fly-by-night operators who made a clean sweep then can repeat their performance. Even so, merchant bankers, underwriters, stockbrokers and all others connected with the new issues market owe a duty to the nation to discipline themselves to ensure that the investors are not taken for a ride again. The unofficial market prior to listing, particularly at centres like Rajkot and Jaipur, and which has proved itself to be the root cause for the several evils associated with the new issues market where the premia are rigged up to entice the investors, needs to be dealt with immediately. While the debate whether or not to regulate this market can go on and the decision that may be taken after weighing the pros and cons and assessing which way the balance of advantage would lie, implemented, not only these transactions need be declared illegal but even the publication of their quotations be also rendered illegal. Such a rigorous dispensation alone can deters the unscrupulous elements from using this market for their benefit to the detriment of the investing public.

A long-term solution to ensure a vibrant new issues market is to permit companies either with a good track record or floated by known entrepreneurs alone to tap this market. Financial institutions, commercial banks and issue houses in the private sector can take all other issues and load them on the market even with a premium later at the propertime. The small beginning made with bought out deals upto Rs. 1 crore companies has touched only the fringe of the problem. Financial constraints that may be faced in the beginning in this behalf will be overcome over a period of time with continuous recycling of funds. What is needed is to make a beginning in this direction. Solutions like evolution of an over-the-counter market for greenfield ventures however laudable be it, cannot be free from the malpractices presently prevalent in the new issues market.

Secondary Market

The tremendous surge in the secondary market has surprised every one. 1987 was the low year of exception when the average daily transactions on the Bombay Stock Exchange were about Rs. 45 crores. From a low level of about Rs. 12 crores in 1982, the average daily turnover zoomed to about Rs. 68 crores in 1986 and is currently and rather amazingly around Rs. 125 crores. The average daily number of deals (either purchases or sales) has also registered a five-fold increase from about 10,000 in 1982 to around 50,000 at present. This is very close to the number of deals of about 70,000 on the New York Stock Exchange and more or less the same number on the London Stock Exchange and if we take the average hourly deals, this is more than double of those on these Stock Exchanges which are open for six and a half hours as against a mere two hour trading on the Bombay Stock Exchange.

Such a sudden increase in the turnover has naturally led to strains on computer capacity. While computer capacity is being continuously upgraded to meet the challenges of a never ending increase in turnover with the proposal for installation of a main-frame computer linked with terminals directly from the trading ring and offices of the stockbrokers having on-line processing capacity being made operative in the near future, what deserves to be noted particularly is that there is practically no problem of un settled transactions, while leading Stock Exchanges of the world like London and Paris continue to groan under similar problems.

Lack of Liquidity

The sudden increase in the turnover has, however, not led to the desired degree of increase in liquidity in all the scrips. It is true that about 700 issues get traded at present, out of a total of about 3,500 issues listed on the Bombay Stock Exchange, as against about 500 issues out of a total of about 3,200 listed issues a year ago. Still over 80 per cent of the turnover is confined to specified shares and even here the top ten scrips...
account for about 75% of the turnover. The Indian stock market is thus a peculiar amalgam of high volatility in respect of a few scrips and low liquidity in respect of a vast majority of them.

While excessive speculation needs no doubt to be curbed, linking deliveries with the turnover and blaming the markets as not being healthy on account of transactions not resulting in deliveries merely displays ignorance of a proper understanding of the complexities of the market mechanism. Deliveries the world over are on a net basis, be it the London market which has a settlement cycle of 14 days, or the U.S. markets which have a settlement cycle of five days or even the Hong Kong market which has a day trade settlement schedule. Smaller Stock Exchanges in the country which have not been able to accept this principle have failed to grow, at any rate to the same extent, as the bigger Exchanges.

Low liquidity for nearly 50 per cent to 60 per cent of the listed issues is the real bane of the Indian stock markets. No systematic efforts have been made till recently to generate liquidity in these issues. Bid and Offer On-line System for Thiny Traded Securities (BOOSTS) launched by the Bombay Stock Exchange in the beginning of this year has not produced results to the desired extent. Concerted efforts for creation of market makers not only in new issues but also in respect of existing ones who could always give two-way quotations within a reasonable range of say 10 per cent need to be made. Financial institutions can and should take the lead in the matter. Reservation of say even one per cent of the new issues and grant of liberal bank finance to market makers would greatly help the process.

Odd Lots

Odd lots constitute another vital area of despair to the investors. Various efforts made in this behalf, like appointment of odd lot dealers and creation of separate odd lot trading session by the Stock Exchanges for which the lead was taken by the Bombay Stock Exchange, arrangements for the purchase of odd lots by some of the managements of their own shares and by some of the financial institutions of some leading companies, etc. have no doubt helped in mitigating the problem. Permitting companies to periodically purchase these shares as in some advanced countries can only be a lasting solution for which it is necessary to remove the statutory prohibition in this regard by amending suitably the Companies Act, 1956.

Transparency of Transactions

Lack of transparency of transactions is also a major shortcoming of our markets. Investor is hardly allowed to know the actual rate of the transactions, he being forced to be content with a statement of net to pay in respect of purchases and net to receive with regard to sales, the brokerage amount being added to the former and deducted from the latter, without indicating the quantum of brokerage and more often than not the rate of the transaction given to the investor is the highest in the case of purchases and the lowest in respect of sales of the recorded transactions of the day. The issue is, however, not so simplistic as this, as there is always the jobber's spread which the dealer cannot escape, and the recorded rates are the actual transacted rates, where the dealer could be a seller, in which case the rate would be lower of the bid and offer rates given by the jobber, or a buyer resulting in the rate being higher of the two rates quoted by the jobber. An ordinary investor is neither aware of this nor able to appreciate it. This rule is often exaggerated as the gap is relatively narrow in the case of active scrips, while the daily range of fluctuations is often five to ten times this gap. The balance of advantage would lie in not only indicating the rate and the brokerage separately but also the time of the transaction, as is the practice in the developed markets of the world.

Insider Trading

Insider trading is the biggest bane of the Indian stock markets. While insider trading is prohibited in almost all parts of the world, rather strangely, no illegality is still attached to such trading, although Sachar Committee in its reports on the Companies Act and Monopolies and Restrictive Trade Practice Act had made a recommendation in this behalf more than ten years ago. What is more important than the legislation, is its effective implementation and time alone will indicate the degree of success we can achieve in this regard.
Resilience of Indian Markets

Despite all the pitfalls and short comings, the Indian stock markets have displayed a remarkable degree of poise and stability in their functioning and proved to be one of the best in the world. As per the study conducted by the Bombay Stock Exchange, the average annual range of fluctuations of all-India Index Number of security prices of ordinary shares of the Reserve Bank of India during the period 1980 to 1987 was one of the lowest in the world, being only 22.5 per cent, next to Australia which was 21.0 per cent, and lower than 24.6 per cent of the London Stock Exchange and 25.4 per cent of the New York Stock Exchange and well below the average of 32.7 per cent of 15 leading stock markets of the world.

The type of collapse that took place on the 19th and 20th October, 1987 in global markets of the world wiping away about 30 per cent of market capitalisation amounting to about $1.8 trillion, solely due to exogenous factors has never taken place in the Indian markets. Insulation of the Indian markets from global markets no doubt helped in ensuring that these cataclysms did not even have their ripples on the former. But how long should this insulation continue in a totally shrunk financial system of the globe, virtually to the level of a village, enabling one to shop around the global market within minutes and round the clock is a matter for consideration. It is true, we have already made a beginning by permitting non-resident Indians and persons of Indian origin resident abroad to operate in the secondary market, albeit to a limited extent of 5 per cent of the paid-up capital of listed companies, and the proceeds of two funds of the Unit Trust of India subscribed by the NRIs and the foreigners and quoted on the London and New York Stock Exchanges being invested in Indian securities. While several of the markets in the emerging markets of the world have opened up in some way or the other and got integrated into the global system, our market which is one of the biggest in these markets too needs to be blended with the global system, with of course all the checks and balances to ensure that flow of hot money into and out of our market does not cause sharp jerks in prices.

The resiliency of the Indian markets has to be attributed basically to the various measures such as margins, limits on holdings, limits on movement of prices, prohibition on further dealings, ban on short sales and long purchases, etc., continuously deployed to control and regulate the market. Contrary to the general belief, it is the forward section of the market which has displayed a greater degree of stability than the cash section. The average annual range of fluctuations of ten leading scrips in the forward section in the Bombay Stock Exchange during the period 1984 to 1987 was 53.8 per cent as against 65.1 per cent in respect of ten leading scrips in the cash section. Credit for this goes to a large extent to the checks and balances ingrained in the forward section and the lack of it in the cash counter. A greater degree of co-ordination in the regulatory systems at the four major Stock Exchanges of Bombay, Calcutta, Delhi and Ahmedabad where forward trading in shares is permitted, can help in instilling better discipline in the system. Votaries of a free, fair and orderly market would do well to realise that a fair and orderly market can rarely be free and a free market can equally rarely be fair and orderly. Financial institutions who are today major players in the market, holding as they do over 30 per cent of the equities, can also help in bringing about better discipline in the market. It is common knowledge that investors come in droves in a bull phase and also go away from the market in droves in a bear phase and it is next to impossible to alter this mass psychology. Equally impossible is to change the attempts of speculators who tend to depress the prices in a declining market and push up the prices in a rising market, thereby accelerating the amplitudes of price variations. It is here where the financial institutions can really play a stabilising role by effecting purchases in a declining market and sales in a rising market and thereby impart a greater degree of stability to the market. It is needless to add that these operations would incidentally also help in increasing the earnings of the financial institutions.

Screen Trading

While no doubt systematic and concerted efforts are being made continuously both by the Stock Exchange authorities and Government to render the Indian stock markets less fragile and more resilient, adequate attention has not been paid to reduce the drudgery involved in these operations. The age-old practice of physical assembly of operators in one place to transact business continues, the only difference being that the markets have moved physically from the shadow of trees to air-conditioned halls. Over two thousand people mill around daily in the trading ring of the Bombay Stock Exchange, shouting and gesticulating all the time during the two-hour trading period to transact business. Fidelity of trading posts at many of the Exchanges has helped in reducing the movement of operators, but the lack of it at some of the Exchanges has virtually
resulted in chaotic conditions, reducing not merely the liquidity of a market already illiquid, but also emergence of parallel markets within the floor. There is a global trend to move towards screen trading with the bids and offers continuously being displayed on large display screens or video monitors and interested parties being thus enabled to transact business at these rates. Screen trading has resulted in the floor of the London Stock Exchange being virtually deserted which the Canadian financial writer, Susan Goelden, has graphically described as conversion of the trading floor into a ground for volley-ball game. New York Stock Exchange, however, is not prepared to switch over to screen trading as it is not yet convinced that the market through screen trading is as competitive as the face to face two-way auction trading on the trading floor which they widened in January, 1988 by addition of a 7,000 square feet area to the existing 30,000 square feet trading floor. Some of the Londoners too remain unconvinced that they have done the right thing. Be that as it may, screens can certainly be used for display of bids and offers and reduce thereby the congestion and noise in the trading ring. This is what, as already stated above, the Bombay Stock Exchange is planning to do by installation of a mainframe computer with terminals in the trading ring and in the offices of the stockbrokers and convert the trading ring into a more habitable place.

An issue closely linked with computerisation is the need to switch over to on-line processing from the system of batch processing that we have at present. Batch processing necessarily results in delay in delivery of shares and payment of price, a settlement trading cycle of 14 days virtually taking another 14 days for settlement of the transacted business, reducing thereby the liquidity of stock market instruments. This needs a structural change of introduction of floor-ticket system with operators instantly keying in the transactions straight from the trading ring. It is not merely a question of accepting this in principle, but is also of being physically able to do so, considering that currently about 25,000 deals are being put through in an hour. Lengthening the trading period to reduce the intensity of the transactions can and should be the answer.

Stock Holding Corporation

Equally laborious is the post-transaction work relating to physical delivery of shares. Delivery of about 30 crore shares worth about Rs. 3,000 crores take place in a year on the Bombay Stock Exchange alone, while another more or less equal amount of delivery takes place on the other 14 Stock Exchanges of the country. It is true that not all of them go to companies for transfer as holders of shares do often dispose of the shares before registration in their names. Even so, 30 per cent to 40 per cent of the deliveries can roughly be estimated to result in actual transfer in the books of companies. Before any transfer is effected in the name of the buyer, there is a tortuous travel of eight stages, viz.,
(i) the selling broker sending the blank transfer forms to the selling client,
(ii) the selling client signing the transfer forms and sending the same alongwith the share certificates to the selling broker,
(iii) selling broker delivering these documents to the buying broker either directly or through the Clearing House,
(iv) the buying broker sending the transfer forms to the buying client,
(v) the buying client returning the transfer forms to the buying broker after signing them,
(vi) the buying broker sending the documents to the company for registration,
(vii) the company sending the certificates back to the buying broker, and
(viii) finally the buying broker despatching the certificates to the buying client, all saddled with risk, not to speak of the mountain load of work and enormous time involved in such a circuitous process.

Most of the global markets have already moved away from this process by creation of Depository Trust Companies which have immobilised the securities and transfers take place only through book-entries eliminating the cumbersome procedure of physical movement of deliveries of scrips among brokers and clients. A beginning has been made in this country by the establishment of Stock Holding Corporation of India Ltd. which initially will be offering the services of acting as a depository to the seven all India financial institutions which have promoted the Corporation and later extend its services to others. Bank of India and the Bombay Stock Exchange will also soon be establishing a Shareholding Corporation which will also act as a depository in respect of 'badia' shares to begin with. Roughly about 1 crore shares worth about Rs. 100 crores would initially be involved. Later, the services would be extended to the shareholdings of stockbrokers and investors.
A major hurdle on the free operation of the Stock Holding Corporation is the restriction on the currency of transfer deed for a period of one year or till the next book-closure, whichever is later. With the causes that led to the introduction of the restriction way back in 1966 being fully taken care of by various other provisions subsequently embodied in the Companies Act and the Income-tax Act, these restrictions need to be done away with lock, stock and barrel, if the cult of equity has to be carried to the four corners of the country, particularly the semi-urban and rural areas, and across the country among the non-resident Indians.

Immobilisation of securities is only a part of the journey to ease the problem. Ultimately we should plan to create a certificateless-society as is being proposed in the United Kingdom by the establishment of Taurus. A proposal to establish a Stock Holding Corporation on these lines was submitted by the Bombay Stock Exchange way back in 1979. Each investor would have an account with the Stock Holding Corporation with the shares purchased by him being credited to his account by a deposit slip and the shares sold by him being debited to his account by a delivery order. The mechanics of opening and operating an investment account would be simplicity itself, akin to pay-in slips and cheques making credit and debit entries respectively in the banking system. Shares will then become as liquid as cash, mobile and freely transferable, as funds flowing through banking accounts.

**Sine Qua Non of Development**

Simplification of trading and settlement processes is no doubt crucial for the development of the securities industry, but that by itself, however perfect be it, will not help in spreading the cult of equity in the country. A prudent and honest management of listed companies and an equally good management of securities houses are a sine qua non to ensure a continuous expansion in the shareholding population of the country to help in the evolution of an egalitarian structure of society. Regulation of the securities industry has also a vital role to play in this regard. Cursily, the securities industry in this country had the least control so far and that too in an economy like ours which otherwise has been subjected to a host of rules and regulations. Even in a country like U.S.A. which believes in a free economy, securities industry is subject to a stringent set of rules. With the formation of the Securities and Exchange Board of India, things are slowly changing and all the segments of the securities industry will come under regulation. With better regulation of this industry, it is expected that the flow of funds into the capital market instruments would be augmented. It is a feasible proposition to ensure that about 25% of the domestic savings are garnered by these instruments every year, as against around six per cent at present.


******
INVESTOR PROTECTION

By
M.R. Mayya
Executive Director, The Stock Exchange, Bombay

Although in terms of market capitalisation and turnover of business, India does not rank within the first fifteen stock markets of the world, the country has amazingly the third largest shareholding population in the world, next only to the United States and Japan who have about 50 million and 25 million shareholders constituting 21 per cent and 20 per cent respectively of the populations of their countries. Even on a conservative estimate, India has at present about 12 million shareholders accounting for 1.5 per cent of the population. What is more important is that with progressively increasing awareness of the utility of investment in shares, the growth rate of the shareholding population can easily be placed around 10 to 12.5 per cent with about 1.2 to 1.5 million new shareholders being added every year. Well by the end of the century, this country can easily boast of nursing about 30 to 40 million shareholders amounting to 3 to 4 per cent of the population.

With debentures and bonds, both convertible and non-convertible, emerging as a major source of finance for the corporate sector, both public and private, from the beginning of the eighties, the number of debentureholders has also increased significantly and can easily be estimated to be about 4 million at present.

Major Objective of Regulation

A major objective of regulation of Stock Exchanges in this country or any other country for that matter of fact is investor protection. The Big Bang which took place in U.K. in October, 1986 was preceded by the Financial Services Act basically designed towards protection of the interest of the investors. In our own country, no Stock Exchange is granted recognition by the Government of India unless its Rules and Bye-laws are in conformity with such conditions as may be prescribed with a view to protecting the interests of the investors. This was fully echoed when the Prime Minister observed in his 1987-88 Budget speech that “Investors’ rights must be fully protected”.

Investor Protection from Companies

Investors need protection not only from stockbrokers but also from companies. Investor protection from companies, however, has not received as much public attention as that from stockbrokers. Besides the provisions embodied in the Companies Act, 1956, the Listing Agreement, which a company seeking enlistment enters with the Stock Exchange before securities of the company are admitted for dealings on the Exchange, provides for a number of safeguards in this behalf. It is proposed to deal with some of the major ones incorporated in the Companies Act and the Listing Agreement.

Interest on Excess Application Money

Because of the inordinate delay in the admission of shares and debentures for dealings on the Stock Exchange, sub-section 2(A) was specifically incorporated in Section 73 of the Companies Act by the Companies (Amendment) Act, 1974 providing for payment of interest by the directors of the company at the rate of 12 per cent per annum on excess application money from the eighth day, the company becomes liable to pay. The Companies (Amendment) Act, 1988 amended this provision putting the responsibility for payment of interest on the company itself, in addition to directors of the company who are officers in default and providing for payment of interest at such rate, not less than four per cent, and not more than fifteen per cent, as may be prescribed, having regard to the length of the period of delay in making the repayment of such money. As the liability in this behalf has become rather difficult to be translated into practice, the Ministry of Finance issued a guideline on the 21st July, 1983 directing payment of interest at the rate of 10 per cent per annum for the delayed period beyond the 70th day from the date of closure of the subscription till the date of posting of the refund orders relating to excess application money. The rate of interest was raised by the Ministry of Finance to 15 per cent per annum on the 27th September, 1985.

Welcome as the above provisions are, in actual practice very few companies have so far paid interest on excess application money, although posting of the refund orders relating to excess application money after the 70th
day from the date of closure of the subscription list is not uncommon. A well intentioned piece of legislation thus remains defeated by companies resorting to ante-dating of the refund orders.

**Issue of Certificates in Market Lots**

According to the listing requirements and Listing Agreement, companies are required to issue, unless the Stock Exchange agrees otherwise and the parties concerned desire, Allotment Letters, Share Certificates, Call Notices and other relevant documents in market units of trading. Companies are also required to sub-divide and consolidate Allotment Letters, Share Certificates, etc., into market units of trading. Despite such clear provisions, a number of companies continue to ignore these provisions and issue these instruments in larger units thereby affecting adversely liquidity of these instruments as delivery of these instruments in the market has invariably to be in market lots.

The Listing Agreement also requires companies to sub-divide and consolidate Letters of Allotment and Share Certificate into denominations other than those fixed for the market units of trading on payment of a nominal fee. Even so, quite a few companies have chosen the liberty of amending their Articles of Association taking powers to refuse applications for transfer of shares in denominations less than the market lot except where transfer is made in pursuance of any provisions of law or statutory order or an order of a competent court of law or where the transfer of shares relates to the transfer of the entire holding of a member consisting of less than the marketable lot. A person holding shares in a lot higher than the market lot is, however, permitted to sell the market lot and retain the residual lot below the marketable lot. The Bombay Stock Exchange has consistently taken the stand that there would be no objection to a company refusing to sub-divide a certificate into several scrips of very small denominations, or to consider a proposal for transfer of shares comprised in a certificate to several parties, involving such sub-division, if on the face of it, such sub-division/transfer appears to be unreasonable or without a genuine need and not otherwise.

**Transfer of Shares**

Under Section 111 of the Companies Act, 1956, a company is given a period of two months from the date on which the instrument of transfer is delivered to the company for effecting the transfer and if a company refuses to do so, the company is required to send notice of the refusal to the transferee and the transferor giving reasons for such refusal. The transferor or the transferee has a right to appeal to the Company Law Board against any refusal of the company to register the transfer within a period of two months from the date of receipt of the notice of such refusal, or where no notice has been sent by the company, within four months from the date on which the instrument of transfer was delivered to the company. The Company Law Board may, after hearing the parties either dismiss the appeal or by order direct that the transfer shall be registered and the company shall comply with such order within ten days of the receipt of the order.

Section 22A of the Securities Contracts (Regulation) Act, 1956, which became effective from the 17th January, 1986 and which is applicable only to listed companies restricts the power of a company to refuse to register the transfer of any of its securities in the name of the transferee only on grounds that (a) the instrument of transfer is not proper or has not been duly stamped and executed or that the certificate relating to the security has not been delivered to the company or that any other requirement under the law relating to registration of such transfer has not been complied with, or (b) the transfer of the security is in contravention of any law or (c) the transfer of the security is likely to result in such change in the composition of the Board of Directors as would be prejudicial to the interest of the company or to the public interest, or (d) the transfer of the security is prohibited by any order of any court, tribunal or competent authority. The company is required to inform its opinion with regard to refusal of registration on any of these grounds within two months from the date on which the instrument of transfer is lodged with it and intimate both the transferor and the transferee about the requirements which need to be complied with for securing such transfer. The company is required to effect the registration within this period of two months if its opinion is that the registration ought not to be so refused. If the company forms an opinion for refusal of transfer on any other ground, the company is required to make a reference to the transferor and the transferee.

The Listing Agreement has abridged the period for transfer to a month from the date of lodgement of the certificate.
Despite such clear cut statutorily laid down period of time for effecting transfers, instances of companies not adhering to these time schedules have become a matter of daily occurrence. While inability of companies to adhere to the time schedule due to reasons like pressure of work with the transfer agents, sudden strike by the employees, etc., is understandable, although not excusable, the practice of some companies to wantonly delaying transfers with a view to diminishing the supply of stocks and to jacking up the prices is reprehensible. Stray cases of action taken by the Bombay Stock Exchange against such companies by suspending dealings in their securities for a few days have had no doubt some effect in the matter but have not proved to be deterrent enough against those companies merily continuing to indulge in such practices.

**Payment of Dividend and Interest**

The Listing Agreement clearly provides that companies have to issue dividend warrants, interest warrants and also cheques for redemption money of redeemable shares or of debentures and bonds payable at par in cities where Stock Exchanges are situated, State Capitals, and other cities with a population of more than five lakhs (as per the 1971 census) and at centres where branches of the bankers to the company are located and collectable at par, with collection charges, if any, being borne by the company, in the case of any bank in the country at centres other than these centres. There are thus 17 centres where recognised Stock Exchanges are situated, 15 State capitals and 7 cities with a population of 5 lakhs (as per the 1971 census) i.e., 39 centres, besides the centres where branches of the bankers to the company, are located, where these instruments are payable at par. This wholesome provision embodied in the Listing Agreement with the laudable objective of ensuring equity among the investors throughout the country stands defeated by quite a few companies, including the leading and well established ones, ignoring the same and making the provision of payable at par applicable only to a few centres and debiting the collection charges in respect of other centres to the investors. (See the map on the next page)

**Take-overs**

Pursuant to a directive issued by Government in April 1984, a new clause viz., clause 40 was inserted in the Listing Agreement by Stock Exchanges to take care of the interest of the non-management shareholders in cases of take-overs. According to this clause, any acquisition of the shares of a company beyond 25 per cent of the voting capital of the company or securing the effective control of management of a company by acquisition of the shares of the existing Directors and others who effectively control or manage the company, irrespective of the percentage of their holding, should be preceded by an offer to the remaining members of the company to acquire their shares at a price not lower than the price at which the shares of the company are being acquired. This, however, subject to the public shareholding not being reduced to less than 20 per cent of the voting capital of the company.

There have been quite a few take-overs ever since this clause came into operation, particularly during the last one year. Unfortunately, this clause has not proved to be effective in taking care of the interests of the non-management shareholders because of four major reasons. First, acquisition of the shares is limited to 24.9 per cent of the voting capital of the company, thus conforming to the letter of the law while totally violating its spirit and brazenfacedly arguing about the correctness of such a move. Secondly, acquisition of the shares would in actuality result in an effective change in the control of management of the company but would not ostensibly look so, as for example when only four out of eight directors change and there is no foolproof way of deciding that there is an effective change in the control of management of the company. Thirdly, there would be no change in the shareholding pattern of the company but in the pattern of shareholding of the parent company holding shares in the company, as a result of which there is a change in the effective control of management of the company. Finally, acquisition of shares ostensibly takes place at a price much below the ruling market price but in actuality at a much higher price, the difference being settled privately.

In order to ensure that the interests of the non-management shareholders are served better, the meeting of the Presidents and Executive Directors of Stock Exchanges convened by the Securities and Exchange Board of India on the 11th February, 1989 felt that the trigger point should be brought down from 25 per cent to 10 per cent and that the Stock Exchanges should have the right to approve the terms and conditions of these deals as also the reasonability of the prices. They were also of the view that where a bidder acquired more than 50 per cent shareholding from a substantial shareholding, he should acquire at least 20 per cent from the minority shareholders at the same price.
The Centres are:

(i) Centres where recognised Stock Exchanges are situated, viz., Ahmedabad, Bangalore, Bhubaneswar, Bombay, Calcutta, Cochin/Ernakulam, Delhi, Guwahati, Hyderabad, Indore, Jaipur, Kanpur, Ludhiana, Madras, Mangalore, Patna and Pune.

(ii) State Capitals not covered by (i) above, viz., Agartala, Aizwal, Bhopal, Chandigarh, Gandhinagar, Gangtok, Imphal, Itanagar, Kohima, Lucknow, Panaji, Shimla, Shillong, Srinagar and Trivandrum.

(iii) Cities with a population of more than 5 lakhs as per the 1971 Census not covered by (i) and (ii) above, viz., Agra, Allahabad, Coimbatore, Jabalpur, Madurai, Nagpur and Varanasi; and

(iv) All branches of the bankers to the Company other than at the centres referred to in (i), (ii) and (iii) above.
Mismanagement of Companies

A major cause of disenchantment of investment in industrial securities is the growing sickness in industrial units leading to a substantial erosion, often exceeding 50 per cent of the par value, in market prices. At the end of June 1987, there were as many as 1,057 non-small scale sick units accounting for a bank credit of Rs.2,680.44 crores and securities of most of these units are listed on the Stock Exchanges with substantial public holdings.

While sickness due to unavoidable and unforeseen factors like changes in policy, power cuts, labour troubles, alterations in the demand for goods, technological advances, etc. is understandable, although not desirable, sickness due to mismanagement is abominable. Stringent action against the errants can help mitigate the severity of the problem and to that extent, however limited, be it, prevent erosion of the confidence of the investing public in investment in industrial securities.

Investor Protection from Stockbrokers

Investor protection from stockbrokers has rightly been talked about and quite a few steps have been taken to guard the interests of the investors in this behalf. There are about 3,000 active stockbrokers who are members of Stock Exchanges and whose activities are subject to the Rules, Bye-laws and Regulations of Stock Exchanges.

Sub-Brokers

There is a fairly good measure of protection to the investors from the stockbrokers. While this has no doubt to be improved upon, the class of sub-brokers who have proliferated all over the country, both in the areas where recognised Stock Exchanges are situated and outside, pose a serious threat to investor protection and it is estimated that about 50 per cent of the complaints against the stockbrokers is because of this class of sub-brokers. On a rough reckoning, there are at least 50,000 such sub-brokers not subject to any regulations constantly posing serious threat to investor protection. Some of the sub-brokers in the jurisdictional areas of Stock Exchanges also commit the illegality of issuing contracts, bills, memos, etc., in their own names to lend authenticity to their operations and the gullible investors who are not normally aware that these can legally be issued only by a member of a Stock Exchange in the jurisdictional areas covered by the Stock Exchange fall a prey to such gimmicks of sub-brokers. It is quite a common occurrence seeing a sub-broker, who, after getting established, suddenly vanishes from the scene collecting the shares given for sale and the money given for purchase by his clients leaving the latter totally hapless. Since there is no nexus between the stockbroker and the clients of the sub-broker, the stockbroker pleads his inability to entertain the claims of the clients of the sub-broker.

In order to overcome this serious lacuna in regulation, a Working Group set up by the Securities and Exchange Board of India, has recommended a system of authorisation of these sub-brokers based on the criteria of professional competence, financial soundness and record of integrity and payment of suitable admission fee, security deposit and annual subscription. The Group has also recommended creation of a Customers' Protection Fund by earmarking 25 per cent of the sub-broker's annual subscription towards this fund. The Group has further recommended that while the sub-broker would be primarily responsible to the client, the principal broker would ultimately be responsible to the client in case of sub-broker's default. The Group was also of the opinion that over a period of time, sub-brokers must be authorised to issue contracts in their own names to their clients. This would obviously need an amendment to the Securities Contracts (Regulation) Act, 1956 which permits contracts to be entered into only between, with or through members of recognised Stock Exchanges in jurisdictional areas.

Rights of Investors Against Stockbrokers

Investors have certain rights embodied in the Rules, Bye-laws and Regulations of Stock Exchanges which most of them are not aware. These include consent of the client before a member enters into a contract with him as a principal, issue of a contract whether as a principal or as an agent after the contract is entered into, right of the client to close out an unfulfilled contract through any other member of the Exchange, lodging of a complaint against any member who fails to implement the stockbroking business with the Stock Exchange authorities who can take disciplinary action including suspension against the member if they are satisfied about the complaint,
reference to arbitration, etc. Adequate publicity in this behalf needs to be undertaken, particularly by the Stock Exchanges, so that rights of investors do not go by default.

Arbitration

A client or a member can refer any claim, difference or dispute with a member or a client, as the case may be, for arbitration under the Rules, Bye-laws and regulations of the Stock Exchange. Arbitration has to be conducted by two members of the Exchange, one to be appointed by each party. In case of any difference between the two arbitrators as to the award, they can appoint an umpire from among the members of the Exchange. During 1986, 1987 and 1988, 68,136 and 111 arbitration cases have been filed out of which 30,92 and 25 cases respectively have been disposed of at the Bombay Stock Exchange.

Although arbitrators are normally required to give the award within four months, quite often there is delay due to the protracted nature of the proceedings which has a frustrating effect on the claimants. A shorter system of these proceedings is required to be evolved so that justice is administered in time.

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

Transparency of Transactions

Lack of transparency of transactions is also a major shortcoming of our markets. Investor is hardly allowed to know the actual rate of the transactions, being forced to be content with a statement of net to pay in respect of purchases and net to receive with regard to sales, the brokerage amount being added to the former and deducted from the latter, without indicating the quantum of brokerage and more often than not the rate of the transaction given to the investor is the highest in the case of purchases and the lowest in respect of sales of the recorded transactions of the day. The issue, however, is not so simplistic as this, as there is always the jobber's spread which the dealer cannot escape, and the recorded rates are the actual transacted rates, where the dealer could be a seller, in which case the rate would be lower of the bid and offer rates given by the jobber, or a buyer resulting in the rate being higher of the two rates quoted by the jobber. An ordinary investor is neither aware of this nor able to appreciate it. This rate is often exaggerated as the gap is relatively narrow in the case of active scrips, while the daily range of fluctuations is often five to ten times this gap. The balance of advantage would lie in not only indicating the rate and the brokerage separately but also the time of the transaction, as is the practice in the developed markets of the world.

Odd Lots

Odd lots constitute a major bugbear for the Indian investors. Out of a total market capitalisation of about Rs.60,000 crores, equities worth about Rs.10,000 crores are in odd lots. Investors normally receive 15% to 20% less than the market price for their sales and have to pay 15% to 20% more than the market price for their purchases of odd lots. Schemes evolved by some of the agencies and companies to fetch a better price for the investors have not proved to be much of a success.

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

A separate trading session has also been arranged on Saturdays beginning from January, 1988 to facilitate odd lot dealings amongst members themselves. These sessions, which will help in consolidation of odd
lots into trading lots dispensing with the requirement of sending odd lots to companies, have proved to be very popular. Delhi and Calcutta Stock Exchanges have also initiated steps similar to those adopted by the Bombay Stock Exchange to facilitate consolidation of odd lots into trading lots. Other Stock Exchanges are also expected to follow suit.

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

Lack of Liquidity

Although there has been more than a ten fold increase in the turnover in the secondary market during the last one decade, the Indian stockmarkets have not yet been able to develop the requisite degree of liquidity in all the listed securities. About 900 issues no doubt get traded at present out of a total of about 3,500 issues listed on the Bombay Stock Exchange as against about 600 issues out of a total of about 250 listed issues a year ago. Still over 80 per cent of the turnover is confined to specified shares and even here the top ten scrips account for about 75 per cent of the turnover. The Indian stock markets are thus a peculiar amalgam of high volatility in respect of a few scrips and low liquidity in respect of a vast majority of them.

No systematic efforts have been made till recently to generate liquidity in listed securities. Bid and Offer On-line System for Thinline Traded Securities (BOOSTS) launched by the Bombay Stock Exchange in January, 1988 has not proved to be effective. Companies seeking entitiment on the Bombay Stock Exchange are now required to appoint market makers. Success of this experiment needs to be watched with interest and transplanted to other Exchanges. Creation of market makers in respect of issues already listed is a more formidable task. Financial institutions can and should take the lead in the matter. Reservation of say even half a per cent of the new issues and grant of liberal bank finance to market makers would help greatly the process of improving liquidity in the Indian stockmarkets.

Insider Trading

Insider trading i.e. trading in securities by persons in possession of material non-public information relating to such securities, which is price-sensitive, strangely remains totally uncontrolled and has proved to be one of the biggest menace to the investors. The provision contained in Section 307 of the Companies Act requiring shareholdings and debentureholdings of directors to be recorded and kept open for inspection of any shareholder or debentureholder during the period of 14 days before and 3 days after the Annual General Meeting of company has proved to be totally ineffective in controlling such trading. Publication of half-yearly results by listed companies as required by clause 41 of the Listing Agreement in operation from the beginning of 1987 has also not minimised such trading. Not only insider trading needs to be prohibited with provision for deterrent punishment for offenders under a suitable statutory framework but also enforced strictly and rigidly. Till such time Government comes out with the legislation, it behoves stockbrokers as trustees of public welfare not to put intractions of "insiders" if they realise that these are based on non-public information.

Manipulation of Prices

Prices are the outcome of a host of factors, fundamental and technical, simultaneously operating on the market. It is almost like a national poll being the outcome of the judgement of hundreds and thousands of people continuously buying and selling in the market. It is, therefore, not possible to say whether the price registered in the market at any point of time is a correct price. Even so, manipulation of prices, always to the detriment of investors, is a common occurrence on Stock Exchanges. Making a fast buck, ensuring success of the public issue, getting higher advances from banks, having lower wealth-tax assessments, etc., are some of the major objectives of manipulation of prices. While manipulation of prices in frequently and thinly traded securities may be difficult, it is easy to do so in infrequently and thinly traded securities.
Strangely, there is no effective deterrent against manipulation of prices in the Indian stock markets. Expanding the quotations and taking disciplinary action against members of Stock Exchanges are unfortunately the only available measures and even these are rarely resorted to by the stock exchange authorities. Drastic penal provision, including institution of criminal proceedings in a court of law against the manipulators, be they members of Stock Exchanges or not, on the lines of similar provisions embodied in the statutes of several advanced countries, is therefore called for if the menace of manipulation of stock prices has at all to be effectively controlled.

Customers' Protection Fund

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

Lack of suitable protection to the clients in the event of a member of a Stock Exchange being declared a defaulter has proved to be a major bottleneck in the flow of funds into industrial securities. The Ministry of Finance had, therefore, directed the Stock Exchanges of the country to set up Customers' Protection Funds. The Bombay Stock Exchange was the first to set up such a Fund. Established in October, 1986, the Customers' Protection Fund of the Exchange is patterned on the lines of the Securities Investor Protection Corporation of the U.S.A. and the Stock Exchange Compensation Fund of the London Stock Exchange. The fund is financed partly by way of a levy on the turnover of members collected at the rate of one rupee for every Rs. 10 lakhs and partly by way of contribution from the listing fees collected at the rate of two per cent. The Fund had Rs. 8.27 lakhs to its credit as on the 31st March, 1989 after having distributed about Rs. 3.50 lakhs to the clients of one of the defaulter members. The Fund is being administered only for the benefit of the clients of the defaulter members of the Exchange and their beneficiaries in respect of genuine investment claims. The compensation that may be paid in respect of any single claim is limited to Rs. 10,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the fund. While there is no ceiling on the amount of compensation that may be paid from the Compensation Fund of the London Stock Exchange, the Securities Investor Protection Corporation of the USA limits the payment to a single customer to $5,00,000 out of which claims on cash, as distinct from claims for securities, would not be more than $1,00,000. The Securities Investor Protection Corporation had $398.3 million to its credit at the end of 1988 besides a line of credit uptil $500 million from the banks and $1 billion from the Securities and Exchange Commission which in turn can borrow the same from the U.S. Treasury. A similar dispensation in this country can help in grant of increased compensation from the Customers' Protection Fund.

Investors' Service Cell

The Bombay Stock Exchange had established a complaints cell about 8 years ago to look specifically into the complaints of investors. In pursuance of a Government directive, the cell was not only rechristened as the Investors' Service Cell in 1986 to demonstrate clearly the service character of the cell but also strengthened with a senior officer heading the cell to render expeditious service to the investors. About 2,000 complaints are received by the cell every month and out of this about 94% are against listed companies and the balance against stockbrokers. In 1988, the Exchange received in all 23,129 complaints - 21,983 against listed companies and 1,146 against members.

The complaints against companies mainly relate to non-receipt of refund/allotment advice, non-receipt of securities, delay in transfer of securities, non-receipt of interest/dividend, non-receipt of brokerage and underwriting commission, etc. Against members the complaints are primarily about non-receipt of securities booked and of sale proceeds of securities sold, non-payment of profits, etc.

The Investors' Service Cell tries its level best to redress the grievances as expeditiously as possible. In fact,
in all the communications to the investors they are requested to contact the cell if their grievances are not redressed within a reasonable time, thereby clearly indicating to them the earnestness of the cell to resolve the problems of the investors. Out of the 23,129 complaints received by the cell in 1988, 17,878 complaints were disposed of.

The Investors’ Service Cell is a bit handicapped while dealing with companies. The only powers the Stock Exchanges have against a deliquent company are suspension of dealings in the securities of the company and delisting of the same, both of which are not in the interest of the investors. The action of suspension of dealings for a few days taken by the Bombay Stock Exchange against a few companies, has, however, proved to be quite effective in as much as the public image of the companies concerned was damaged to a great extent. The Stock Exchanges need to be clothed with powers not only to fine the companies and the officers in default of these companies but also to launch both civil and criminal proceedings against them in a court of law in serious cases. As a safeguard against any misuse of these powers, Stock Exchanges may be permitted to do so only after obtaining prior approval of the Government in the matter.

With regard to disputes between members of the Stock Exchange and their clients, the Investors’ Service Cell tries to resolve the dispute administratively as far as possible. Only when the cell is not able to do so due to claims and counterclaims by the disputants, the client is asked to refer the matter to arbitration. Such cases are, however, relatively few.

Conclusion

There is no stronger stimulus than investor protection to the growth of the market as the investor is the king of the market. This was clearly adumbrated by President Franklin D. Roosevelt when he remarked, while signing the Securities Act of 1933, that the goal of securities regulation is to change the law from caveat emptor (buyer beware) to caveat venditor (seller beware).

Despite the unprecedented growth of the market during the last one decade, investments in corporate securities including units of the Unit Trust of India hardly account for 7 per cent of the financial savings of the household sector and we have a long way to go before we are able to tap about 25 per cent of the household sector’s financial savings as is being done by several of the advanced countries of the world. Stock Exchange administration which acts as a custodian of investor protection has a crucial role to play in this regard. It has not only to be competent and honest but also tough to withstand the pressures from the mighty corporate world on the one hand and the fast growing securities industry on the other both of which largely contribute for the finances of the Stock Exchanges. The Securities and Exchange Board of India set up by the Government of India in April, 1988 with the primary objective of investor protection will no doubt act as a citadel of investor protection preventing any hesitant Stock Exchange administration from detracting from the path of proper dispensation of justice.

RECENT TRENDS IN SECURITIES MARKETS

BY

M.R. Mayya
Executive Director, The Stock Exchange, Bombay

Let me right at the outset convey my deep sense of gratitude to the Western India Regional Council of the Institute of Chartered Accountants of India for having invited me to deliver S. Vaidyanath Iyer Memorial Lecture this year.

I have intentionally chosen the theme "Recent Trends in Securities Markets" more with a view to focussing attention on some of the problems attendant on these trends and to initiate a debate for arriving at a sort of national consensus in the matter in order to solve these problems than with a view to finding fault with the system. No system in the world is perfect nor is the Indian securities market. It should, however, be our constant endeavour to reduce as far as possible the infirmities in the system so that the objectives of having a dynamic and vibrant capital market providing constantly the long-term funds for the industry and trade on the one hand and of ensuring safety, liquidity, return and appreciation to the growing class of investors on the other are achieved.

Burgeoning Markets

The Indian stock markets have grown so sharply in the 80s that the decade itself has been christened as a 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. 90 crores raised from the new issues market in the seventies, about Rs. 6,000 crores are being raised during 1989-90 and an amount of about Rs. 10,000 crores is expected to be raised in 1992-93. The daily turnover on the Bombay Stock Exchange alone has shot up from about Rs. 10 crores in 1979-80 to about Rs. 125 crores in the current year. The number of shareholders has also risen sharply from about a million to about 12 million during this period, catapulting this nation to the position of being the third largest shareholding population nation in the world, next only to the United States of America and Japan which have about 80 million and 25 million shareholders respectively. Market capitalisation has also shot up from about Rs. 3,500 crores to about Rs. 60,000 crores during the last one decade, accounting for about 15 per cent of the GN P now as against about 3 per cent ten years ago.

The basic thrust for the market came initially from the statutory requirement to dilute alien holdings by the FERA companies. About 115 companies offered about Rs. 125 crores in the latter half of the 70s generating about 2 million shareholders in the country. These companies offered not only a steady return on investment but also a sharp and instant appreciation in prices to the investors. Closely on the heels of this dilution, came the offer of convertible debentures by established and renowned houses enticing again the investing public into the securities market. The policy of deregulation, delicensing and decontrol followed by Government soon thereafter gave the necessary fillip for the private sector to expand, diversify and modernise in a big way without much of hassles. This naturally led to an exponential growth of the stock markets. The investor in turn reaped handsome gains by their investment in equities.

Equities, which acted as a poor hedge against inflation right till the seventies, changed their role from the beginning of the eighties, alluring the investors to divert their savings into the corporate sector. As against an overall negligible rise of just 2 per cent in the index number of ordinary shares over sixties and of about 60 per cent over the seventies as compiled by the Reserve Bank of India, the rise since the beginning of the eighties has been 260 per cent while the rise in the index number of wholesale prices during these periods has been about 80 per cent, 160 per cent and 75 per cent respectively.

The unprecedented growth of the Indian stock markets has resulted in these markets becoming a major market in the emerging stock markets of the world, next only to Taiwan and Korea, both in respect of market

© Tea of S. Vaidyanath Iyer Memorial Lecture delivered at Bombay on Thursday, the 4th January, 1990.
capitalisation and turnover. Naturally this has attracted the eyes of the globe, most of whom are now eager to invest in our market.

Increase in the number of Stock Exchanges

To accommodate the fast growing securities industry, Government has been granting recognition to more and more Stock Exchanges during the last few years. While there were only eight recognised Stock Exchanges in the country in 1978, there are today as many as 18 and it appears that there could be about 30 to 40 Stock Exchanges functioning in the country by the end of the century. While there is a school of thought that does not favour the increase in the number of Stock Exchanges, mainly on the ground that smaller Exchanges could be less efficient, in a country of a continental size like that of ours and inhibited by poor communication facilities, it would be a prudent proposition to have more and more Stock Exchanges set up at different centres so that the investing public have easy access to the members of Stock Exchanges who are subject to requisite degree of discipline.

Membership of Stock Exchanges

With the increase in the number of Stock Exchanges, the number of active stockbrokers has also no doubt increased during the last one decade. There are today about 3,000 active stockbrokers all over the country as against about 1,250 a decade ago. Important as the need for the increase in the membership is, there is an equally imperative need to ensure improvement in the quality of the services by stockbrokers. Individual stockbrokers could amalgamate themselves into firms and companies so as to be able to deploy the resources in a more effective way. In order to encourage the emergence of such entities, the constitution of Stock Exchanges has recently been amended to provide for companies with majority of directors having unlimited liability to become members of Stock Exchanges. Financial Institutions and their subsidiaries and subsidiaries of banks in the public sector have also been permitted to become members of Stock Exchanges, although entry of these institutions at some of the Stock Exchanges has been temporarily held up. The apprehension of the stockbroking community that these institutions will make inroads into their business is not fully true. The capital market is widening very fast and the existing strength of the stockbroking community is inadequate to cope up with the increase in the growth of the securities industry. Besides, the amount of confidence that can be generated by public institutions in the minds of the investors is tremendous. Fair competition between the public sector bodies and the existing class of stockbrokers should only lead to better services to the investors. However, emphasis should be more, at rate in the initial years, on additonality of services, like market making capacity, building up new clientele, particularly in rural and semi-urban areas, etc. where the services rendered by the present class of stockbrokers are woefully inadequate.

There is a mistaken belief that induction of professionals such as Chartered Accountants, Company Secretaries, etc. would actually lead to professionalisation of the membership of Stock Exchanges. This is, however, not true, as intricacies of the securities industry can be understood only by making a thorough study of this industry. With this end in view, the Bombay Stock Exchange has recently started a Training Institute for the stockbroking community. The Institute proposes to start separate courses for investors in the near future.

The question of improving the quality of membership is no doubt important but an equally important area needing instant attention is relating to sub-brokers who are at present outside the purview of regulation. On a rough reckoning, there are at least 30,000 such sub-brokers all over the country. Some of these sub-brokers in the jurisdictional areas of Stock Exchanges also commit the illegality of issuing contracts, bills, memos, etc. in their own names to lend authority to their operations and the gullible investors who are not normally aware that these can legally be issued only by a member of a Stock Exchange in the jurisdictional areas covered by the Stock Exchange fall a prey to such gimmicks of sub-brokers. It is quite a common occurrence seeing a sub-broker, who after getting established, suddenly vanishes from the scene collecting the shares given for sale and the money given for purchase by his clients, leaving the latter totally hapless. Since there is no nexus between the stockbroker and the clients of the sub-broker, the stockbroker pleads his inability to entertain the claims of the clients of the sub-broker.

In order to overcome this serious lacuna in regulation, a Working Group set by the Securities and Exchange Board of India, has recommended a system of authorisation of these sub-brokers based on the criteria
of professional competence, financial soundness and record of integrity and payment of suitable admission fee, security deposit and annual subscription. It is earnestly hoped that these recommendations, which are presently under the consideration of various Stock Exchanges, would be implemented at the earliest so that the gullible investing public do not have to deal with some one who is not accountable to any authority.

Restructuring the Governing Boards of Stock Exchanges

In tune with the developments the world over, complexification of the Governing Boards of the Indian Stock Exchanges too is undergoing a change, with more of non-broker directors being inducted into the board rooms of the Stock Exchanges. While ultimately the extent of representation to the non-broker directors can be up to 50%, as is the case in most of the leading global stockmarkets, the process of inducting more and more of non-broker directors should not be delayed. As a non-broker director can wield tremendous influence on the deliberations of the Board, each one of them being in a position to sway the deliberations, it is absolutely essential to ensure that the right type of people having a high degree of integrity and independence and imbued only by public interest are selected for these posts. Suitable payment to these persons for the services they render needs also to be made.

Primary Market

The growth of the primary market during the last decade is a tribute both to the entrepreneurial class availing of the funds provided by this market on the one hand and to the vast investing public supplying these funds on the other. While no doubt the growth needs to be sustained, several problems confronting this market have to be tackled so that unscrupulous elements are prevented from taking undue advantage of the growth.

The unofficial market prior to listing where the premia are rigged up by interested parties, particularly the management, underwriters and merchant bankers, to entice the investors needs immediate attention. There is a school of thought which favours regulation of this market on the lines of "as and when issued contracts" in the U.S. While the debate whether or not to regulate this market can and should continue and a decision be taken after weighing the pros and cons and assessing which way the balance of advantage would lay, these transactions should in the meantime not only be declared illegal but even the publication of their quotations be also rendered illegal. Such a rigorous dispensation alone can detract the unscrupulous elements from using this market for their benefit to the detriment of the investing public.

Manipulation of share prices at the time of further issues is a common occurrence. The process starts well before a company seeks permission from Government for issue of further capital. Not only an attempt to get a premium on the basis of prices so manipulated is being made but attempts at manipulating prices continue thereafter to lure the investors to subscribe for these further issues. Later when the allotments are made, it is quite a common spectacle to find these prices slide down to their natural levels, often below the offer price. While attempts to stabilise prices at the time of further issues are quite understandable and also justifiable, the attempts to manipulate prices are, to say the least, reprehensible. Equally reprehensible are the attempts by others, be they speculators or rival groups, to depress the prices. Unfortunately, there is no effective deterrent provision at present against manipulation of prices in the Indian stock markets. Expunging the quotations and taking disciplinary action against members of Stock Exchanges are unfortunately the only available measures and even these are rarely resorted to by the Stock Exchange authorities. Drastic penal provision, including institution of criminal proceedings in a court of law against the manipulators, be they members of Stock Exchanges or not, on the lines of similar provisions embodied in the statutes of several advanced countries, is, therefore, called for, if the menace of manipulation of stock prices has at all to be effectively controlled.

There is also inordinate delay in admitting the securities for trading, primarily because of the delay in collection of application forms from the different centres of the country and to some extent delay in the processing of these applications, issue of allotment letters/share certificates and posting of these documents to the applicants by the issue houses. Vigorous and sustained efforts in this behalf should normally enable trading being permitted even within four weeks while in actually companies are not able to comply with these requirements even after 70 days from the date of closure of the subscription list in respect of public issues and six weeks from the date of closure in respect of rights issues. It is needless to emphasise that this affects greatly liquidity of investments. Strict
monitoring by Stock Exchanges has no doubt helped to minimise the delay. While one would not normally like to suggest establishment of separate securities houses to attend to the work of collection of application forms, the inordinate delay experienced in this behalf, does prompt one to make a suggestion. It is, therefore, time that some thought is being given in this regard.

The provision for payment of interest on excess application money needs scrutiny. Although companies are required to pay interest on excess application money at the rate of 15% from the 70th day from the date of closure of the subscription list till the date of refund of the money, not many companies seem to be adhering to this stipulation, by undertaking the refund orders. Alert investors should bring concrete instances of such malpractices to the notice of the authorities concerned for instant remedial action.

Frequent entry into the market by some companies, particularly those involved in expansion, diversification and modernisation is truly indicative of the vibrancy of the Indian capital market. Unfortunately, the practice followed by some of them of delaying not only allotments but subsequently not returning shares lodged with them for sub-division, consolidation and transfer in time, thereby creating an artificial scarcity in the market with a view to manipulating the prices in the secondary market, has harmed the investors greatly. It is therefore, essential to ensure that there is a time gap of at least one year between two consecutive issues or alternatively companies may be permitted to enter the market again only six months after the listing of the previous issue.

Permitting companies to offer convertible debentures with provision for conversion at two or three points, the latter towards the end, is indeed a welcome proposition as the market in these debentures continues to remain active because of the close linkage between equity and these debentures. What, however, need to be fixed right at the beginning are the terms of conversion, at all the points, including the last one. Leaving these terms open, tantamounts to offering an open gift to the managements to rig up the prices, which they can do more easily if the quantum of shares emanating after the initial issues is not significant, to gain a higher premium.

A major cause for the recession in prices in the secondary market in 1986 and 1987 was that several fly-by-night operators entered the market mopping up the hard earned savings of the investors by giving misguided advertisements and also jacking up prices in the unofficial market. It is essential to learn from this experience and to ensure that this does not get repeated. Companies which are able to reward instantly the investors both by way of a return and also appreciation in prices, should as far as possible only be allowed to enter the market. Others should be encouraged to have recourse to other avenues of finance like bought-out deals by financial institutions, venture capital funds, etc. This should be made universal embracing even the mega issues. It is heartening to observe in connection that one or two companies have come out with safety-net proposals for small investors for an initial period of one year or so after allotment. Rigid adherence to these provisions is, however, absolutely necessary.

Yet another disturbing development is the reckless manner of issue of circulars and pamphlets by underwriters and others making tall claims not mentioned in the prospectus. More disturbing is the manner in which returns are calculated and even advertised in newspapers on the basis of historical prices which often are manipulated. Marketing a new issue is no doubt a difficult proposition but that should be no excuse for misguiding the gullible investing public.

Another major drawback of the new issues market is lack of adequate instruments. Equities and equity-linked instruments like convertible debentures and non-convertible debentures are the only ones in the market. Preference shares have virtually dried out of the market. Cumulative convertible preference shares, in respect of which Government had issued guidelines in 1984, have practically proved to be a non-starter. A second look at these instruments with a view to assessing whether they could be made active is called for. A number of other instruments like debentures of shorter duration say of three years, debentures on tap, warrants, zero coupon bonds, mutual funds in the private sector, etc. could be introduced to ensure a broader participation in the securities market. The question of offering shares of public sector undertakings, at least by way of further issues, and to an extent of say not more than 25% so as to ensure that the Government control on these public sector undertakings do not get whittled down in any way, needs also consideration. The process of privatisation which is a global phenomenon, including some of the East European countries, have not only helped governments to impart
sobriety to the budgetary-making process but also to increase sharply the shareholding population. For example, in Great Britain, the process of privatisation has led to a three-fold increase in the shareholding population to 16% in 1986. It would, therefore, not be proper to adopt a dogmatic approach in the matter.

Secondary Markets

The sharp increase in the turnover in the secondary market, welcome as it is, has unfortunately not generated the requisite degree of liquidity in the market. It is true that about a thousand securities are currently being traded on the Bombay Stock Exchange out of a total of about 3,500 securities listed on the Exchange. While a substantial portion of the securities, roughly about 25% of them, do not get traded at all in a year, 80 securities in the specified group and another 23 securities in the non-specified group account for nearly 85% to 90% of the trading. Even here, the top 10 scrips account for about 75% of the turnover. The Indian stock markets are thus a peculiar amalgam of high volatility in respect of a few scrips and low liquidity in respect of a vast majority of them. The cycle needs to be broken by appointment of market-makers who could be called upon to give continuously two-way quotations within a spread of not more than 10%, at least in respect of those securities where public interest is significant. The wide spreads between the bids and offers in respect of relatively less thickly traded securities, which often are as high as 50% of the mean rates, has led to a shift of the interest of the brokers from the clientele business to the trading pit. There is greater monetary incentive to act as a jobber in the trading ring than to serve the clients outside. Market-makers need suitable incentives not only by way of supply of securities but also by way of liberal advances from banks. Market-making function, which has been totally neglected hitherto, calls for immediate attention.

The pattern of trading at some of the Stock Exchanges which have a cycle of 14 days settlement period in respect of non-specified securities also needs alteration, as it takes virtually another cycle of 14 days for realising the proceeds of the shares sold and delivery of the shares bought. While the switch-over to the emerging international pattern of a rolling settlement on the third day after the trade day may take sometime, the question of reducing the period of trading cycle to five days of a week and settling the same in the following week needs urgent consideration. This cannot, however, be implanted into the specified group, as long as it continues to be an amalgam of cash and futures, providing as it does, the facility not only to give and take delivery but also to carry forward the transactions from one settlement period to another.

The physical hazards involved in the trading rings of the Indian stock markets also need to be done away with. There are about 2,500 persons in the trading ring of Bombay Stock Exchange milling around during the trading hours to transact business. Trading through computer screens is progressively becoming the order of the day in most of the markets of the world. London and Singapore Stock Exchanges have already totally done away with the trading rings. The Kuala Lumpur Stock Exchange would be following suit shortly. The Tokyo Stock Exchange too has dispensed with the trading ring except in respect of 150 active scrips. With the Bombay Stock Exchange planning to have a mainframe computer with the terminals directly linked with the offices of the stockbrokers, it is proposed to dismantle the trading ring in respect of thinly traded securities. Gradually the concept can be extended to the thickly traded securities too, subject, of course, to the acceptance of the same by the stockbroking community.

Equally laborious is the post transaction work relating to physical delivery of shares. Delivery of about 30 crore shares worth about Rs. 3,000 crores take place in a year on the Bombay Stock Exchange alone, while another more or less equal amount of deliveries take place on the other 17 Stock Exchanges of the country. It is true that not all of them go to companies for transfer as holders of shares do often dispense of the shares before registration in their names. Even so, 30 per cent to 40 per cent of the deliveries can roughly be estimated to result in actual transfer in the books of companies. For effecting any transfer of shares, there is a tortuous travel of eight stages, from the selling broker sending the blank transfer forms to the selling client on to the buying broker despatching the certificates to the buying client, all saddled with risk, not to speak of the mountain load of work and enormous time involved in such a circuitous process.

Most of the global markets have already moved away from this process by creation of Depository Trust Companies which have immoblised the securities and transfers take place only through book-entries eliminating
the cumbersome procedure of physical movement of scrips among brokers and clients. A beginning has been made in this country by the establishment of Stock Holding Corporation of India Ltd., which initially will be offering the services of acting as a depository to the seven all-India financial institutions which have promoted the Corporation and later extending its services to others. The Bombay Stock Exchange and the Bank of India have also made a beginning by establishing BOI Shareholding Corporation which will initially act as a depository in respect of deliveries involved in badla transactions estimated to be about 3 crore shares worth about Rs. 300 crores. Later, the services of the Corporation would be extended to the shareholdings of stockbrokers and investors.

A major hurdle on the free operation of the Stock Holding Corporation is the restriction on the currency of transfer deed for a period of one year or till the next book-closure, whichever is later. With the causes that led to the introduction of the restriction way back in 1966 being fully taken care of by various other provisions subsequently embodied in the Companies Act and the Income-tax Act, these restrictions need to be done away with lock, stock and barrel, if the cult of equity has to be carried to the four corners of the country, particularly the semi-urban and rural areas, and across the country among the non-resident Indians.

Immobilisation of securities is only a part of the journey to ease the problem. Ultimately we should plan to create a certificateless-society as has already been done in Norway and Denmark and as is being proposed in the United Kingdom by the establishment of TAURUS. A proposal to establish a Stock Holding Corporation on these lines was submitted by the Bombay Stock Exchange way back in 1979. Each investor would have an account with the Stock Holding Corporation with the shares purchased by him being credited to his account by a Deposit Slip and the shares sold by him being debited to his account by a Delivery Order. The mechanics of opening and operating an investment account would be simplicity itself, akin to pay-ins and cheques making credit and debit entries respectively in the banking system. Shares will then become as liquid as cash, mobile and freely transferable, as funds flowing through banking accounts. It is high time the authorities concerned move in this matter, if need be, by appointing a High-Power Committee to look into various aspects of the proposal.

Transparency of Transactions

Lack of transparency of transactions is also a major shortcoming of our markets. The investor is hardly allowed to know the actual rate of the transactions, he being forced to be content with a statement of net to pay in respect of purchases and net to receive with regard to sales, the brokerage amount being added to the former and deducted from the latter, without indicating the quantum of brokerage and more often than not the rate of the transaction given to the investor is the highest in the case of purchases and the lowest in respect of sales of the recorded transactions of the day. The issue is, however, not so simplistic as this, as there is always the jobber’s spread which the dealer cannot escape, and the recorded rates are the actual transacted rates, where the dealer could be a seller, in which case the rate would be lower of the bid and offer rates given by the jobber, or a buyer resulting in the rate being higher of the two rates quoted by the jobber. An ordinary investor would be neither aware of this nor able to appreciate it. This use is often exaggerated as the gap is relatively narrow in the case of active scrips, while the daily range of fluctuations is often five to ten times this gap. The balance of advantage would lie in not only indicating the rate and the brokerage separately but also the time of the transaction, as is the practice in the developed markets of the world.

Odd Lots

Odd lots constitute a major bugbear for the Indian investors. Out of a total market capitalisation of about Rs. 60,000 crores, equities worth about Rs. 10,000 crores are in odd lots. Investors normally receive 15% to 20% less than the market price for their sales and have to pay 15% to 20% more than the market price for their purchases of odd lots. Schemes evolved by some of the agencies to buy odd lots and the efforts made by the Bombay Stock Exchange of appointing authorised odd lot dealers with norms for their operations and having separate trading session on every alternate Saturday have no doubt helped in alleviating the gravity of the problem. Laudable as these efforts are, they need to be supplemented for solving the problem effectively. Companies may themselves be permitted to purchase the odd lots of their own shares, preferably at the ruling price with the safeguard of prior
approval of the General Body to prevent any misuse by the Board of Directors. These shares can then be re-issued in marketable lots, if need be. Similar provisions exist in countries like the U.S.A. and U.K. and there is no reason why we should not emulate the same. Companies Act, 1956 will, of course, have to be amended for the purpose.

Insider Trading

Insider trading i.e., trading in securities by persons in possession of material non-public information relating to such securities, which is price-sensitive, strangely remains totally uncontrolled and has proved to be one of the biggest menaces to the investors. The provision contained in Section 307 of the Companies Act requiring shareholdings and debentureholdings of directors to be recorded and kept open for inspection of any shareholder or debentureholder during the period of 14 days before and 3 days after the Annual General Meeting of a company has proved to be totally ineffective in controlling such trading. Publication of half-yearly results by listed companies as required by clause 41 of the Listing Agreement in operation from the beginning of 1987 has also not minimised such trading. Not only insider trading needs to be prohibited with provision for deterrent punishment for offenders under a suitable statutory framework but also enforced strictly and rigidly. Till such time Government comes out with the legislation, it behoves stockbrokers as trustees of public welfare not to put in transactions of “insiders” if they realise that these are based on non-public information.

Take-Overs

Take-overs which has gripped the western world has now spread to this country too. In fact, there is nothing wrong in a take-over as it strengthens the very fabric of the corporate sector by enabling replacement of inefficient management by efficient ones. It would, however, be desirable to ensure that energies of the entrepreneurial class do not get dissipated by engaging themselves in take-over battles. It is equally important to ensure that whenever there is a take-over, a fair deal is meted out to the non-management shareholders. To achieve this objective, a new Clause was incorporated in the Listing Agreement of Stock Exchanges pursuant to a directive issued by the government in April, 1984. According to this Clause, any acquisition of the shares of a company beyond 25 per cent of the voting capital of the company or securing the effective control of management of a company by acquisition of the shares of the existing Directors and others who effectively control or manage the company, irrespective of the percentage of their holdings, should be preceded by an offer to the remaining members of the company to acquire their shares at a price not lower than the price at which the shares of the company are being acquired. This is, however, subject to the public shareholding not being reduced to less than 20 per cent of the voting capital of the company.

There have been quite a few take-overs ever since this clause came into operation, particularly during the last one year. Unfortunately, this clause has not proved to be effective in taking care of the interests of the non-management shareholders because of four major reasons. First, acquisition of the shares is limited to 24.9 percent of the voting capital of the company, thus conforming to the letter of the law while totally violating its spirit and brazenfacedly arguing about the correctness of such a move. Secondly, acquisition of the shares would in actuality result in an effective change in the control of management of the company but would not ostensibly look so, as for example when only four out of eight directors change and there is no foolproof way of deciding that there is an effective change in the control of management of the company. Thirdly, while there would be no change in the shareholding pattern of the company there would be a change in the pattern of shareholding of the parent company holding shares in the company, as a result of which, there would be a change in the effective control of management of the company. Finally, acquisition of shares ostensibly takes place at a price much below the ruling market price but in actuality at a much higher price, the difference being settled privately. It is high time that the existing framework is suitably modified to plug all these loopholes so that the interests of non-management shareholders are duly taken care of.

Resilience of Indian Stock Markets

Despite all the pitfalls and short-comings, the Indian stock markets have displayed a remarkable degree of poise and stability in their functioning and proved to be one of the best in the world. As per the study conducted by the Bombay Stock Exchange, the average annual range of fluctuations of all-India Index Number of security
prices of ordinary shares compiled by the Reserve Bank of India during the period 1980 to 1988 was one of the lowest in the world, being only 24.1%, next to 23.0% of London and 23.3% of Switzerland and lower than 25.1% of New York Stock Exchange and well below the average of 31.4% of the 15 leading stock markets of the world.

The type of collapse that took place on the 19th and 20th October, 1987 in global markets of the world wiping away about 30 per cent of the market capitalisation amounting to about $1.8 trillion and again recently on the 13th October, 1989, solely due to endogenous factors has never taken place in the Indian Markets.

The resiliency of the Indian markets has to be attributed basically to the various measures such as margins, limits on holdings, limits on movement of prices, prohibition on further dealings, ban on short sales and long purchases, etc., continuously deployed to control and regulate the market. Contrary to the general belief, it is the forward section of the market which has displayed a greater degree of stability than the cash section. The average annual range of fluctuations of ten leading scrips in the forward section in the Bombay Stock Exchange during the period 1984 to 1987 was 3.8 per cent as against 65.1 per cent in respect of ten leading scrips in the cash section. Credit for this goes to a large extent to the checks and balances ingrained in the forward section and the lack of it in the cash counter. Financial institutions who are today major players in the market, holding as they do over 30 per cent of the equities, can also help in bringing about better discipline in the market. It is common knowledge that investors come in droves in a bull phase and also go away from the market in droves in a bear phase. The role of the financial institutions in stabilising the market by effecting purchases in a declining market and sales in a rising market and thereby imparting a greater degree of stability to the market is, therefore, crucial. It is heartening to note that financial institutions have discharged this obligation in a significant way, particularly during the last three years.

**Customers’ Protection Fund**

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

Lack of suitable protection to the clients in the event of a member of Stock Exchange being declared a defaulter has proved to be a major bottleneck in the flow of funds into industrial securities. The Ministry of Finance had, therefore, directed the Stock Exchanges of the country to set up Customers’ Protection Funds. The Bombay Stock Exchange was the first to set up such a Fund. Established in October 1986, the Customers’ Protection Fund of the Exchange is patterned on the lines of the Securities Investor Protection Corporation of the U.S.A. and the Stock Exchange Compensation Fund of the London Stock Exchange. The fund is financed partly by way of a levy on the turnover of members collected at the rate of one rupee for every Rs. 10 lakhs and partly by way of contribution from the listing fees collected at the rate of two per cent. The Fund has about Rs. 15 lakhs to its credit at present after having distributed about Rs. 3.50 lakhs to the clients of one of the defaulter members. The compensation that may be paid in respect of any single client is, however, limited to Rs. 10,000. While there is no ceiling on the amount of compensation that may be paid from the Compensation Fund of the London Stock Exchange, the Securities Investor Protection Corporation of the USA limits the payment to a single customer to $5,00,000. The Securities Investor Protection Corporation had $398.3 million to its credit at the end of 1988 besides a line of credit up to $500 million from the banks and $1 billion from the Securities and Exchange Commission. A similar dispensation in this country can help in granting of increased compensation from the Customers’ Protection Fund. It is needless to point out that the money and securities lodged with a sharebroker need to be totally protected and there just can’t be any compromise on this fundamental principle.
Securities and Exchange Board of India

In most of the countries in the world, the securities industry is regulated by a separate watchdog. Even the traditional U.K. has found it necessary to set up the Securities and Investment Board. We have no doubt strong arms in the Government like the Stock Exchange Division in the Ministry of Finance and the Department of Company Affairs for regulating and controlling the securities industry. There are, however, a number of areas like insider trading, a host of intermediaries like merchant bankers, issue houses, investment consultants etc., who do not come today under any semblance of regulation. Besides there is an imperative need to have better coordination among the Stock Exchanges. It is, therefore, necessary that the Securities and Exchange Board of India set up in April, 1988 is clothed with suitable statutory powers. The Securities and Exchange Board of India, on its own part, should, however, take adequate care to ensure that there is no duplication of work. By and large, stock markets of the country have been functioning quite satisfactorily under the direct control and regulation by the Ministry of Finance. This is, however, not to say that there is no scope for further improvement. Constant interference of the rule regulators can have the unintended effect of not only increasing paper work not commensurate with results but also blunting the efficacy of their regulatory weapons and making inroads into the autonomous character of Stock Exchanges.

Conclusions

There is a general misconception that Stock Exchanges are symbols of capitalism and that in a country like ours which has objectives to the effect “that the ownership and control of the material resources of the community are so distributed as best to subserve the common good” and “that the operation of the economic system does not result in the concentration of the wealth and means of production to the common detriment” enshrined in its Constitution, these symbols of capitalism could negate these objectives. This is, however, far from the truth. Stock Exchanges can, in fact, be used as instruments to achieve the objectives set out in the Constitution of India and reiterated by the President of the country when in his recent address to the Parliament he observed that “the Government proposes to adopt an alternative model of governance and development based on socialist ideals of economic equality and social justice”. It is pertinent to observe in this connection that establishment of Stock Exchanges are taking place not only in countries which have market economies, partial or full, but also in communist countries like China, the Soviet Union and others. Public purchase of stocks is no more regarded as revulsion to private property in these countries. But what, however, is required is to ensure that the Stock Exchanges function on healthy lines and that the interest of the investors are fully taken care of. For this purpose, the issuers of securities must be fair and honest in the management of the affairs for which the securities have been issued. According to a recent study about industrial sickness, deficiency in management accounted for 52% of the large affected units, other reasons being market recession and environmental factors, technical factors and faulty planning, infrastructural factors, labour troubles, etc. Investors who are unfortunate in investing in such mismanaged companies are prone to shy away from the market. Stockbrokers who act as the intermediaries between the issuers and receivers of securities initially and as the intermediaries among the receivers themselves subsequently must also be fair and honest in their dealings. No matter, however, honestly the stockbrokers behave and, however, dishonestly the investors act, there is a general feeling that investors are invariably taken for a ride by the stockbrokers. This feeling has slowly to give way to one of mutual trust which needs hard and assiduous labour on the part of the stockbrokers. Administration of the Stock Exchanges has also to be not only competent but also totally honest and tough, not being subject to pressures from any quarters, however, powerful they be. If these three objectives are achieved, at least to a considerable extent, if not fully, we can achieve the goal of rising levels of savings moving into industrial securities and the population of holders of industrial securities continuously increasing. Before we march into the 21st century, let us have an India of at least 50 million shareholders, accounting for about 5% of the population and sharing in the prosperity of the nation. Equity holders can only foster the concept of growth with equity.

THE STOCK EXCHANGE, BOMBAY - NEW PROFIT - GENERATING OPPORTUNITIES FOR OVERSEAS INVESTORS

BY

MR. M. R. MAYYA
EXECUTIVE DIRECTOR
THE STOCK EXCHANGE, BOMBAY

It is indeed a matter of great pleasure for me to participate in this conference on "Business and Investment Opportunities in India" and to share with you my views and experiences on "The Stock Exchange, Bombay - New Profit - Generating Opportunities for Overseas Investors".

The giant strides that the Indian economy has taken in recent years and the air of openness and policies of liberalisation pursued by the Indian Government have aroused keen interest among the international financial fraternity which today looks upon India as a major growth market for the decades ahead. My colleagues will be telling you about different interesting facts of the Indian scenario while I have this onerous task to take you on a short trip to the Stock Exchange, Bombay which with the exponential growth in its activities during the eighties has emerged as a major stock market not only among the developing markets but also as a market comparable with many of the developed markets. I have structured my talk under three major parts, viz., (i) The market at present and the growth parameters, (ii) emerging trends and developments, and (iii) investment opportunities for overseas investors.

Let us then begin with the great stock market revolution in India during the eighties in which the Bombay Stock Exchange being the premier Stock Exchange in the country played an important role. It will give you an opportunity to know about the developments which will be the cornerstone of future growth of the stock market in India.

The Market at Present and Growth Parameters

Eighties has been a decade of exponential growth in the Indian stock markets. Not only the markets have witnessed a quantum jump in the activities but more importantly the very characteristics of the Indian stock market has undergone a metamorphosis to emerge as a major entity in the Indian financial system itself. The changes have been so profound in character that it is rather difficult to visualize any comparable development in any other parts of the world.

Primary and Secondary Market Growth

The extent of growth can best be understood through quantitative terms. For example the capital mobilized from the primary market has grown from a mere Rs. 900 million during the late seventies to over Rs. 80 billion during the current year 1989-90 and it is expected to cross the landmark of Rs. 100 billion by 1992-93, if not earlier. Indeed the recent spate of issues of over Rs. 2.5 billion each, which are mega issues by Indian standards, entering the market in quick succession and mature investor response to them coupled with good performance of several modest issues which entered the market amidst the blitzkrieg of mega issues were clear indicators of the soundness of the Indian capital market and the growing maturity of Indian investors.

On the secondary market, the average daily turnover on the Bombay Stock Exchange which accounts for nearly 2/3rds of the total secondary market turnover in India has jumped from about Rs. 100 million in 1979-80 to over Rs. 1,250 million (Rs. 1.25 billion) during the current year. More important is the fact that around 50,000 deals are struck on the Bombay Stock Exchange during the two hour trading session on any given day.

© Speech delivered at the Conference organized by the Institute for International Research, Hong Kong on 9th February 1990 at Parana Hotel, Hong Kong.
which are quite comparable to about 80,000 deals executed on the New York Stock Exchange and about 30,000 deals that take place on the London Stock Exchange. In fact, the per hour intensity of deals in Bombay is far more than that on New York and London as they have longer trading periods. Settlement of these deals in a smooth and orderly manner without any breakdown of the machinery has earned the confidence of the investors even though the prolonged settlement process leads to delay in realisation of transaction proceeds. Market capitalization is today of the order of about Rs.600 billion, roughly 15 per cent of the GNP which though modest by international standards has improved from an abysmally low figure of Rs.55 billion constituting barely 3 per cent of GNP a decade ago.

India has the third largest investor population of around 12 million equity holders exceeded only by the United States with about 50 million stockholders and Japan with about 25 million stockholders. As a percentage of total population, however, it is about 1.5 per cent, the scope for expansion being thus tremendous.

The growth of Indian stock market during the current decade has earned for itself an important place in the global capital markets. The International Financial Corporation which monitors the Emerging Capital Markets in the world has put India as a major emerging market being among the first five major emerging markets in the world.

This impressive growth has been a direct result of the several measures adopted by the Government of India to liberalize its industrial and fiscal policies which encouraged the growth of the private sector and also investment in corporate securities. The first major step in this direction was taken in mid-seventies with imposition of a statutory requirement to dilute alien holdings by the companies coming under the Foreign Exchange Regulation Act, 1973 so as to become Indian companies. About 125 companies underwent Indianization process during the latter half of seventies and offered about Rs.1250 million of capital to the Indian public. These companies enjoying a good public image and profitable operations in the country enabled the Indian middle class to acquire equity of sound companies at favourable rates and ensured chances of better returns through regular dividends and more importantly significant capital appreciation. Dilution of FERA companies expanded the Indian investor population by about two million and more importantly brought in the non-traditional investors into the vortex of capital markets.

This was soon followed by a spate of issues of convertible and non-convertible debentures from several large and well established companies going in for expansion and modernisation through sizeable capital investments. These two instruments, particularly the former, constructed and issued on attractive terms also won the confidence of the investors and provided a further impetus for the growth of the stock market.

Eighties also witnessed a shift in the Government attitude towards the private sector. The Government pursued a more open door policy and set in the process of liberalisation. Several restrictions, which stemmed the growth and diversification of industrial sector especially for the large houses, were done away with. Industries were not only permitted to set on the process of natural growth but were also allowed to expand and diversify amidst more liberal policy framework. Moreover, core sector of industries from which the private sector was kept away hitherto was opened to the private sector initiative. These companies turned to the stock market to mobilise the huge resources required to finance their new capital intensive projects and contributed to its expansion.

Equities were a poor hedge against inflation in India for a long time extending up to the end of seventies. The current decade, however, witnessed a new resurgence in security prices enticing the investors to be active in stock market. While the Reserve Bank of India index of security prices showed a marginal rise of 2 per cent during the sixties and around 60 per cent in seventies, the index has smartly upped by over 275 per cent during the eighties. By comparison, the wholesale price index had registered an increase of 80 per cent, 160 per cent and 75 per cent respectively during these three decades.

The growing interest of the investors in the stock market securities found several other instruments to invest in when beginning with 1986 several mutual funds were floated by the Indian financial institutions and subsidiaries of the banks whose proceeds are being invested on the stock market. Entry of mutual funds on the one hand provided an effective intermediation for non-traditional investors with moderate resources and lack of experience of the stock market to profit from the stock market investments. On the other hand, they have provided a stabilizing force on the stock market cushioning the wide speculative swings which otherwise harm the investors.
In fact, stability of the Indian stock market during the current decade is a distinguishing factor by itself. The exponential growth during the eighties and alternating phases of bullish fervour of 1985-86 followed by a prolonged recession of 1985-88 and subsequent re-emergence of buoyant trend did not destabilize the market structure. The smooth absorption of the manyfold growth in the activity was achieved without any major problems. This could be achieved because of the constant monitoring and finely tuned regulatory system adopted by the Exchange authorities. The type of collapse that took place on the international stock markets on the 19th and 20th October, 1987 and again recently on the 13th October, 1989 due to endogenous factors has never occurred on the Indian stock markets because of constant vigil on the operations on the markets.

A study conducted by the Bombay Stock Exchange on stability of a market as measured by the volatility of the Stock Exchange indices has indicated that the Indian market was one of the stabilest markets in the eighties with the volatility of price movements in India being significantly lower than those on various other international markets and being only marginally higher than the markets in London, Canada, Japan and Switzerland. This has conclusively indicated that the Indian stock markets have matured significantly and are able to withstand the variations in fortunes without having any perceptible influence on the fairness and orderliness in the market.

**Emerging Trends and Developments**

It is not contended that the Indian stock market is perfect and that there are no imbalances, structural or otherwise, in the markets. There are several deficiencies, some structural and others arising out of the growth syndrome. What is, however, heartening is that we in the Bombay Stock Exchange are currently in the midst of a major process of transformation which will have far reaching consequences and will considerably mitigate the problems if not totally solve them. Some of these measures are discussed below.

**New Building Complex**

The present trading ring of the Bombay Stock Exchange, which is a make shift arrangement, is extremely crowded with the result that the efficiency in executing deals is under constraints of physical movement and auditibility. Several of the brokers are also facing acute shortage of space with many of them having been provided with only a table space which is hardly conducive for efficient operations and maintaining sanctity of broker-client confidentiality.

In order to overcome these twin problems and to meet the requirements of future, the Stock Exchange has embarked upon construction of a new building which will house a state of art trading ring comparable with the best trading rings in the world. Keeping in tune with the practices adopted in the world over, it is proposed to have only about 150 highly active scripts for trading on the floor while the remaining scrips will be traded through screens. The building will also provide more space to the stockbrokers and thereby help to improve their efficiency. The building is expected to be ready for occupation latest by the end of 1991.

**Professionalisation of Stockbroking**

Stockbroking has traditionally been an entrepreneurial business carried out by the individuals or partnerships. There had been no professional standards set or precribed for one to enter this business. While the system had worked to everyone's satisfaction so far, it has its own inadequacies to meet the requirements of the future. A step to rectify this lacuna has been taken through the recent permission given to the corporate entities to become members of the Stock Exchanges. Similarly, All-India Financial Institutions or their subsidiaries and the subsidiaries of the commercial banks in the public sector will also soon become members of the Bombay Stock Exchange. Professionals from other disciplines such as accounting, secretarial practice, management, etc., are also being inducted as members to improve professionalization of the stockbroking business. However, we want to develop in the long run stockbroking as a distinct and independent profession by itself and a move in this behalf has already been made by the establishment of a training institute which is training Stock Exchange members and their associates in the first instance. It is proposed to make this institute as an entry point to the stockbroking business so that only those with the requisite outfit become stockbrokers.
Computerisation and Back Office Automation

Presently, the settlement process in the Stock Exchange is computerised but uses batch process of operations which has proved to be inadequate to cope up with the growing volume of business. Similary back office work in stock brokers offices, bulk of which is presently handled manually, has also increased tremendously. The Exchange has therefore undertaken a multi faceted computerisation programme which will provide for on-line settlement and back office automation in brokers' offices. This will not only reduce the settlement cycle but also provide for screen trading in a large number of less active scrips thereby helping in generation of greater liquidity to these scrips. Moreover, it will enable the Exchange to provide better information to the investors on a real time basis. The operations in the offices of the stockbrokers will also be rendered more efficient following reduction in their back office work. Besides, there will be a qualitatively better and real time monitoring of the market developments so that effective and timely measures to regulate the market can be taken.

Establishment of a Share Depository

Immobilization of share certificates and transfer of securities through ledger entries are of fundamental importance for a stock market to cope up with the growing volume of business. Experiences of U.S. stockbrokers during the sixties and early seventies when torrential flow of paper work threatened the stability of that market are well known to require any further elaboration. These ushered in share depositories in the U.S. followed by other markets. In India also steps have already been initiated towards this end. A beginning has already been made with the establishment of Stock Holding Corporation of India which presently handles the shares of financial institutions. The Bombay Stock Exchange has also taken steps in association with Bank of India who presently handle the Clearing House work of the Exchange, to form a BOI SHARHOLDINGS LTD., which once fully established will take over the Clearing House functions and also act as a depository for the members of the Stock Exchange in the first instance and its services will be extended to investors at large in a phased manner. Some other such depositories at other Exchanges are also being contemplated. Legal and other difficulties are being presently sorted out to ensure smooth functioning of these depositories. Once such depositories become fully operational, the market will be able to absorb a far greater volume of business than what is being handled at present.

Immobilisation of securities is only a part of the journey to ease the problem. Proposals are on to create a certificateless-society as has already been done in Norway and Denmark and as is being proposed in the United Kingdom by the establishment of TAURUS. In fact, a blueprint to establish a Stock Holding Corporation on these lines was submitted by the Bombay Stock Exchange way back in 1979. Each investor would have an account with the Stock Holding Corporation with the shares purchased by him being credited to his account by a Deposit Slip and the shares sold by him being debited to his account by a Delivery Order. The mechanics of opening and operating an investment account would be simplicity itself, akin to pay-in slips and cheques making credit and debit entries respectively in the banking system. Shares will then become as liquid as cash, mobile and freely transferable, as funds flowing through banking accounts. It may, however, take some time for India to launch on to a certificateless society.

Investor Services

While the Bombay Stock Exchange came into existence way back in 1875 as an organization to protect the character and status of the brokers, it today acts as a repository of investors' interests. It takes cognizance of the acts of omissions and commissions carried out whether by the members brokers or by the listed companies which adversely affect the interests of the investors and ensure their speedy redressal.

The Bombay Stock Exchange has an Investors' Services Cell which takes cognizance of the complaints of investors whether against the stockbrokers or the companies. Around 4,000 complaints are received by this Cell every month which are immediately taken up and pursued for redressal of grievances. This Cell has the distinction of having been efficient in its operations and achieved a high disposal rate which in turn has today earned the confidence and trust of the investors.

It is also necessary to indemnify an investor from the losses that he has to suffer if a stockbroker defaults.
To provide such cover, the Stock Exchange has established a Customers' Protection Fund, which at present insures the investors to the tune of Rs.10,000 for their genuine investment claims against a defaulting stockbroker. The fund today has a corpus of about Rs. 1.5 million and since its establishment in 1986 the fund has paid about Rs. 0.35 million to the clients of a defaulting broker.

Investment Opportunities for Overseas Investors

Investment on Indian stock markets at present is not fully open to foreigners. The market has thus been insulated from the vagaries of international financial climate so as to enable it to develop and stabilize. This has been considered necessary as the economy is still not mature enough to withstand the destabilising forces from outside. As a result, foreign investment has been subject to a well defined and comprehensive provisions embodied in the Foreign Exchange Regulation Act of 1973. Direct foreign investment is a rule allowed only in collaboration units wherein the foreign collaborator can contribute between 40% and 74% depending upon the status of the industry. Direct investment on stock markets is not allowed to foreigners except the non-resident Indians. Foreigners can, however, subscribe to the extent of 40% in a company owned by the non-resident Indians. Foreigners can also invest through the intermediation of country funds or offshore mutual funds floated for the purpose. Direct foreign investment is also permitted in case of specific funds floated by organisations such as the Asian Development Bank or the Commonwealth Development Corporation.

Non-Resident Indian Investment

While foreigners as a rule are not allowed to invest in the securities market, non-resident Indians are encouraged to invest in Indian securities both on repatriable and non-repatriable basis. The term non-resident Indian is a broad one encompassing within its orbit Indian citizens who are out of India either for business or employment and also persons of Indian origin who are citizens of other countries. Facilities provided to non-resident Indians are also available to a company predominantly owned (at least 60%) by the non-resident Indians. These non-resident Indian investments are subject to the rules and procedures prescribed for the purpose by the Reserve Bank of India as a central monetary and exchange regulatory authority.

Prior to the series of liberalisations made in the 1982-83 Budget with regard to investment by non-resident Indians, there did exist certain facilities for such investments. For example, non-resident Indians could freely purchase units of the Unit Trust of India, Government securities and National Plan Savings Certificates. Non-Resident Indians also could invest in securities of Indian companies on non-repatriable basis of both capital and income accruing therefrom. Income from units and investment in units was completely exempt from income-tax and wealth tax respectively for non-resident Indians with effect from the 31st October, 1978. In October, 1975, the Government also permitted non-resident Indians to subscribe to the new equity issues by new companies for setting up new projects in all industries barring certain exceptions governed by the Import Trade Control Public Notice dated the 8th February, 1974 which included industries like coal, textiles, milkfood, leather, matches, beer and alcoholic beverages, etc. Investment and income therefrom were fully repatriable provided such investments were through inward remittances or Non-resident External (NRE) Accounts.

The scheme was further liberalised in 1976 and NRIs were permitted to subscribe up to 74% of the issued capital of the company in respect of priority industries such as metallurgical industries, electrical equipments, transportation, industrial machines and machine tools, fertilizers, drugs and pharmaceuticals, chemicals, paper and cement, etc. Investment in other industries was also permitted provided the investor undertook an obligation to export at least 60% of the output which was further enhanced to 75% of the output in case of industries reserved for the small-scale sector.

As the facilities provided so far failed to achieve the desired objectives and there was no significant net inflow of non-resident Indian funds, the Government extended a series of liberal measures for attracting non-resident Indian investments through 1982-83 and 1983-84 budgets. These measures were widespread and as far as the securities investment is concerned had the following features.

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

B. Portfolio investment in shares and convertible debentures was also liberalised with full benefits of repatriation provided they are purchased through a Stock Exchange and the purchase by a non-resident Indian does not exceed one percent 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 5% of the paid up capital of a company was imposed on total non-resident Indian investments under the portfolio scheme. There are, however, no limits on investment in non-convertible debentures and Mastershares of UTI.

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

The above mentioned facilities of investment are available to overseas companies, partnership firms, societies, trusts and other corporate bodies owned directly or indirectly to the extent of at least 60% by non-resident Indians.

There are special tax concessions available to investment by non-resident Indians. These include the following:

(i) Interest income from units and National Savings Certificates is completely exempt from the income tax and the investment exempt from wealth tax.

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

(iii) Investment in “Foreign Exchange Assets” are exempt from wealth tax.

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

Even though non-resident Indians have been provided extensive incentives for investment in India their response so far has been modest. As on 30th November, 1989, total direct investment of non-resident Indians in India was to the tune of Rs.16.72 billion while under portfolio scheme they had invested Rs.731.6 million in Indian securities. It is estimated that the total investible funds of non-resident Indians as a group are in excess of Rs.1500 billion. Thus their investments in India at present are a little over one per cent of their total investible funds.

In order to mobilize non-resident Indian investment funds in India, several mutual funds have been exclusively floated for mobilization of these resources. Important among these are India Investment Fund by ANZ Grindlays, Jardine Fleming's IF India Pacific Trust and CIFCO Hill Samuel Unit Trust. Their performance seems to have been modest, but it is hoped that over the years these funds will do better and many more such funds will be floated.

Offshore Mutual Funds

Dynamism of Indian stock markets during the eighties has caught the attention of international financial community. Resurgence of Indian economy, presence of a well diversified industrial base and the process of liberalization of policies and mere openness in industrial and economic activities, a vast and growing
domestic market and availability of the requisite infrastructure to become a major international trade partner, alongside the sophistication of its financial markets puts India in a very special position and as safe a bet for investment as possible in any securities market across the world. It is but natural then that there is a renewed interest in India.

Revival of Indian economy and industries could not have come about at a more opportune time. The decade has witnessed a broadening of parking places for the global funds. Japan which had for many years dominated the market for foreign investments is peaking out while prospects in other developed countries are also rather limited and the fund managers in their quest for better opportunities have turned their eyes towards new industrialized countries of South East Asia and other developing countries like India.

While direct foreign investment in India is not permitted except for the investment by non-resident Indians as already indicated earlier and through collaboration management for others, via media has been found through flotation of country funds and offshore Mutual Funds. Country funds have proved their efficiency and utility for mobilization of foreign capital resources for investment in the country from which the fund has emanated. Several countries across the globe have tapped this source very successfully and India joined their rank through the launching of India Fund in London during 1986 by the Unit Trust of India - the major mutual fund operator of the country. This fund of the size of 110 million was succeeded by another fund, “India Growth Fund” launched by UTI once again, in New York in 1987 which had mobilized U.S. $50 million. Last year State Bank of India launched a private placement mutual fund “India Magnum Fund” in millions, Netherlands and following overwhelming response the fund was closed at $157 million. Several more of such funds are being structured by various operators to cater to different types of investors and will be launched in the days ahead. Agencies like Asian Development Bank and Commonwealth Development Corporation have also shown keen interest in the Indian stock market and a part of the proceeds that these institutions are mobilizing for investment in their constituent countries will be invested in the Indian stock market securities.

Performance of the three major country funds from India has been heartwarming. India Fund and India Growth Fund after an initial lacklustre performance are presently among the best performers within the several country funds. Both of these funds are quoted well above their Net Asset Value (NAV). The latest available figures for the end of December, 1989 show that India Fund with an NAV of 219.6 pence was quoted at 245 pence while India Growth Fund with an NAV of 14.79 was being quoted at 18.50. They are exceptions to the general rule that the market trades in such funds at prices lower than their Net Asset Values. Besides in October, 1988 India Fund came out with a rights issue and despite of subdued stock market trends in the international arena, was subscribed to the tune of 66% of the offerings which is considered to be a good performance in the country fund market. The strength of these country funds is all the more remarkable because of the continuous depreciation of Indian rupee vis a vis the major currencies of the world including the US dollar and British Pound.

There are still few hindrances in the way of full growth of the Indian offshore mutual funds, mainly the withholding tax of 45 per cent on long-term capital gains and the deprecating rupee value. It may be observed that several countries in Asia - Korea, Malaysia, Pakistan and Taiwan to name a few do not tax the long-term capital gains. Taxation policies are by nature dynamic and flexible and given the present liberalisation these anomalies could be corrected with the passage of time. Depreciating rupee is a reflection of structural imbalance in the Indian economy and foreign trade that the country is facing at present but should get corrected in the coming years.

Future Prospects

Future prospects of the stock market in India along with prospects of profitable participation therein may be the question uppermost in the minds of foreign investors. As already stated India has embarked on an irrevocable process of liberalization of its industrial and economic policies. Indian industry is on the threshold of massive growth and diversification during the current decade. It will necessitate large investments which will have to be mobilized mainly from the stock markets. Bourgeois Indian middle class has already developed a niche for securities investment which should see further expansion in the years ahead. The door has not been fully thrown open to direct foreign investment but if the trends the world over are any indicators then India would also be an integral part of the global securities market. There will be an imperative need to encourage direct foreign investment subject, of course, to proper safeguards as access to institutionalized funds is becoming more and more restricted. Once this integration takes place, India will bridge an important slot between the Japanese and European markets and in the process will become a major market in its own rights.
India as of today is one of the stablest democracies in the developing world wherein there is a well developed legal and administrative system so necessary to instil a confidence in investors. Moreover ever expanding middle class and a strong and diversified economic and industrial base gives India an enormous advantage to become a major international economy in the years ahead. This would make investment in Indian stock markets an attractive proposition, safe from vagaries of fluctuating policies and sound for substantial returns. On her part, India like several developing economies of the world is in need of financial resources to finance its projects and plans. Forty two years of Independent India has shown that we in India make a judicious use of scarce resources. Development of the stock market infrastructure is an ongoing dynamic process co-ascentiously and zealously pursued with a sense of mission. Investment on the Indian stock markets should therefore be as safe and as secure as in any of the developed markets in the world. The day may not, therefore, be far when the Indian stock market becomes an integral part of the global stock market circles.


* Paper
NRI INVESTMENT IN INDIAN SECURITIES MARKET

BY

Shri M.R. Mayya,
Executive Director
The Stock Exchange, Bombay

The Indian stock market, because of its unprecedented growth and expansion during the decade of eighties and more importantly prospects of even greater expansion during the years ahead, is increasingly being looked upon as the market with vast potential by not only the resident Indians but also by the international financial fraternity. The market as at present, however, is not fully open to foreigners although investments by non-resident Indians is allowed both in the primary and secondary markets and very liberally in the former. This is considered necessary because the Indian market is still not mature enough to withstand the pressures from outside, which could at times be destabilizing. This has, of course, the advantage of insulation from the vagaries of international financial climate.

As a result, foreign investment has been subject to well defined and comprehensive provisions embodied in the Foreign Exchange Regulation Act of 1973. Direct foreign investment is as a rule allowed only in collaboration units wherein the foreign collaborator can contribute between 40 per cent and 74 per cent depending upon the status of the industry but cannot directly invest in stock markets.

While the Indian stock market is basically for Indians and foreigners as a rule are not allowed to invest in the Indian securities market, non-resident Indians are being increasingly encouraged to invest in Indian securities both on repatriable and non-repatriable basis. The term non-resident Indian is a broad one and within its ambit encompasses not only the Indian citizens who are out of India either for business or employment but also the persons of Indian origin who are citizens of other countries. Investment facilities enjoyed by the non-resident Indians can also be availed of by overseas companies, partnership firms, trusts, societies and other corporate bodies predominantly owned (at least to the extent of 60 per cent) by the non-resident Indians. These non-resident Indian investments are subject to the rules and procedures prescribed for the purpose by the Reserve Bank of India as a central monetary and exchange regulatory authority.

Liberalisation of Policies for NRI Investment

Facilities for non-resident Indians to invest in India existed for a long time but they received a major thrust following liberalisation of policies to a greater extent in the 1982-83 Budget. For example, prior to 1982-83 Budget, the non-resident Indians could freely

purchase units of the Unit Trust of India, Government securities and National Plan Savings Certificates. Non-Resident Indians also could invest in securities of Indian companies on non-repatriable basis of both capital and income accruing therefrom. Income from units and investment in units were completely exempt from income tax and wealth tax respectively for non-resident Indians with effect from the 31st October, 1978. In October, 1975, the Government also permitted non-resident Indians to subscribe to the new equity issues by new companies for setting up new projects in all industries barring certain exceptions governed by the Import Trade Control Public Notice dated the 8th February, 1974 which included industries like coal, textiles, milkfood, leather, matches, beer and alcoholic beverages, etc. Investment and income from such investment was fully repatriable provided such investments were through inward remittances or Non-resident External (NRE) Accounts.

The scheme was further liberalised in 1976. Non-resident Indians were permitted to subscribe upto 74 per cent of the issued capital of the company in respect of priority industries. The list of priority industries included metallurgical industries, electrical equipments, transportation, industrial machines and machine tools, fertilizers, drugs and pharmaceuticals, chemicals, paper and cement. Investment in other industries was also permitted provided the investor undertook an obligation to export at least 60 per cent of the output. This obligation was further enhanced to 75 per cent of the output in case of investment in industries which were reserved for the small-scale sector.

These measures, however, failed to achieve the desired goals as the facilities provided so far did not lead to a significant net inflow of non-resident Indian funds for investment purposes. The Government, therefore, promulgated a series of liberal measures for attracting non-resident Indian investments beginning with the 1982-83 and 1983-84 Budgets. These measures were widespread in their scope and as far as the securities investment is concerned had the following features.

Investment on Repatriable Basis

Investment in new issues of companies on full repatriation basis was allowed up to 40 per cent of the fresh issues of equity and preference capital by either a new or an existing company raising fresh capital through prospectus. NRIs could also invest to the same extent in convertible securities floated by the companies. Investment in capital raised by either private or public limited companies other than through the issue of prospectus was also permitted up to 40 per cent of the issued capital subject, however, 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 (75 per cent in case of industries reserved for the small scale sector), investment was permitted to the extent of 74 per cent.

Portfolio Investment on Repatriable Basis

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

**Investment on Non-repatriable Basis**

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

**Tax Concessions**

There are special tax concessions available to investment by non-resident Indians. These among others include the following:

(i) Interest income from units and National Savings Certificates is completely exempt from the income tax while the investment is exempt from the wealth tax.

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

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

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

Even though the non-resident Indians have been provided extensive incentives for investment in India, their response so far has been anything but significant. As on the 30th November, 1989, total direct investment of non-resident Indians in India was just Rs. 16.72
billion only which is hardly one per cent of the capital raised during this period while under
the portfolio scheme they had invested Rs. 731.6 million in Indian securities which again
is a little more than one per cent of the total market capitalization. It is estimated that the total
investible funds of non-resident Indians as a group are in excess of Rs. 2,500 billion with
annual accruals of over Rs. 250 billion. The investments in India by the non-resident Indians
at present is thus less than one per cent of their total investible funds and hence offers a vast
and untapped potential.

This vast potential has been of late realized and various measures are being under-
taken to attract such investment on a larger scale. In order to mobilize non-resident Indian
investment funds in India, quite a few mutual funds have been exclusively floated for
mobilization of these resources. Important among these are the two India Investment Funds
by ANZ Grindlays, Jardine Fleming's JF India Pacific Trust and CIFCO Hill Samuel Unit
Trust. Their performance seems to have been modest, but it is hoped that over the years these
funds will do better and many more such funds will be floated. The full potential for NRI
investment in India has so far not been realized because of the several problems faced by the
NRIs while investing in Indian securities. Non-resident Indians have also to some extent
participated in the offshore Mutual Funds. Launching of the India Fund in London in 1986
by the Unit Trust of India heralded this era. This fund of the size of 110 million pounds was
succeeded by another fund, "India Growth Fund" launched by UTI once again, in New York
in 1987 which had mobilized US $ 60 million. Last year State Bank of India launched a
private placement Mutual Fund "India Magnum Fund" in Antilles, Netherlands and follow-
ing overwhelming response the fund was closed at $ 157 millions. Canbank Mutual Fund
will also shortly be launching in association with Indo-Suez Asia Investment Services Ltd.,
an offshore fund called "IS Himalayan Fund". The fund is expected to collect $ 100 million,
75 per cent of which will be invested in the Indian secondary markets. The shares of the fund
which will be offered at $ 10.40 per share will be quoted not only on the International Stock
Exchange, London but also on the Amsterdam Stock Exchange. Several more of such funds
are being structured by various operators to cater to different type of investors and will be
launched in the days ahead. Agencies like Asian Development Bank and Commonwealth
Development Corporation have also shown keen interest in the Indian stock market and the
part of the proceeds that these institutions are mobilizing for investment in their constituent
countries will be invested in the Indian stock market securities.

Performance of the country funds from India has been heartwarming. India Fund and
India Growth Fund after an initial lacklustre performance are presently among the best
performers within the several country funds. Both of these funds are quoted well above their
Net Asset Value. The latest available figures for the end of April, 1990 show that India Fund
with an NAV of 217.47 pence was quoted at 258 pence while India Growth Fund with an NAV
of $ 12.72 was quoted at $ 14.50. They are exceptions to the general rule that the market
trades in such funds at prices lower than their Net Asset Values. Besides in October, 1988
India Fund came out with the right issue and Inspite of subdued stock market trends in the
International arena, was subscribed to the tune of 66 per cent of the offerings which is
considered to be a good performance in the country fund market. The strength of these country funds is all the more remarkable because of the continuous depreciation of Indian rupee vis-a-vis the major currencies of the world including the US dollar and the British pound.

Problem Areas

1. Poor Marketing of Securities:

There is a two-fold problem in marketing of Indian securities to the non-resident Indians. First, relatively smaller size of issues and corresponding ceiling on issue costs forbids companies and the merchant bankers from effective marketing of issues and as a result the NRIs do not get adequate information about the prospective issues. A way out could be to exempt the genuine issue expenses relating to the marketing of securities to non-resident Indians from the ceiling on issue costs. Secondly, and perhaps more importantly, several issues aggressively marketed during the 1985-86 boom particularly by the fly-by-night operators failed to produce the 'promised' or 'implied' returns to the investors which has naturally resulted in non-resident Indians burning their fingers. This led to cooling of the NRI enthusiasm for the Indian stock issues. As a result, over the years the NRI investment in new issues has shown a declining trend. For example, a large number of capital issues offered to the NRIs in 1989-90 went begging. Out of 187 Indian companies which went public that year, 31 offered capital to the tune of Rs. 1,799 million for NRI investment. However, as many as 18 issues were undersubscribed while eight issues were just fully subscribed and only five issues were significantly subscribed to by the non-resident Indians.

It is necessary that the NRI funds be tapped with due diligence. This segment needs to be nursed with utmost care so that a long-term mutually rewarding relationship is established and nurtured. Merchant bankers from both the public and the private sector will have to share a greater responsibility in this regard. Issues should and must be promoted among the NRI's as indeed within the country on much more objective and fairer basis. Lack of information about the Indian stock markets in foreign newspapers and journals is acting as a major bottleneck. Attempts made by the Bombay Stock Exchange to induce newspapers like the Financial Times of London and the Asian Wall Street Journal to give quotations of atleast a few leading scrips on a regular basis have not so far borne any fruit.

A particular mention needs to be made in this connection of a leading company which offered Rs. 37.5 million to the non-resident Indians. As many as about 700 applications for the shares of the face value of Rs. 35 million were rejected by the company on flimsy grounds like Power of Attorney not being lodged in time, age being not mentioned, income tax permanent account number not being given, etc. It was rather unfortunate that the efforts of the Bombay Stock Exchange for a reconsideration of the issue did not succeed as the company adhered to purely legalistic grounds, ignoring the wider aspect of the issue. Had the issue been undersubscribed, there was little doubt about the acceptance of all the applications.
2. Procedural Formalities:

Non-resident Indians are often exasperated with the several formalities that have to be completed in order to build and maintain an Indian stock portfolio. These formalities are essential from the Indian point of view but for the non-resident Indians accustomed to easier procedures followed in the freer markets they may appear to be time consuming and quite bothersome and hence dissuade them from investing in the Indian markets. First, there is no reason why the permission granted by the Reserve Bank of India for sale of securities by non-resident Indians should be valid for four years only. A blanket permission to sell any time even after four years cannot result in any misuse of the facility. Secondly, in the case of an NRI investor desiring to reinvest the sale proceeds of their existing shareholding, at present they are required to take specific permission of the Reserve Bank of India for such reinvestment. But within the time taken by the Reserve Bank of India for giving such permission the designated bank where he has the NRE account deducts the tax at source at the applicable rate of income tax. For the investor to get his money back he has to apply for getting the refund. This can easily be avoided if on the basis of declaration by the NRI that he is reinvesting the sale proceeds, the banks are instructed not to deduct the tax at source. Thirdly, sale of shares held by non-resident Indians in favour of citizens of India or persons of Indian origin resident abroad on a non-repatriation basis is permitted without Reserve Bank’s permission if the shares are purchased by the transferee from the stock market through a member of a recognised stock exchange in India and the proceeds of such shares sold by the transferer are credited to his ordinary non-resident account with a bank authorised to deal in foreign exchange in India with no rights of repatriation outside India, pursuant to a notification issued by the Ministry of Finance on the 4th May, 1983 by virtue of the power vested in the Government under section 19(5) of the Foreign Exchange Regulation Act. When such shares sold are delivered to the investee company for registering the transfer, they must bear an endorsement accordingly under the stamp and signature of the member of the Stock Exchange through whom the shares were sold. A similar exemption is not available to non-resident Indians in respect of debentures, whether convertible or non-convertible, held by them. They have to obtain the permission of the Reserve Bank of India for the sale of debentures even if the sale is on non-repatriation basis. There is no reason not to extend this exemption to debentures by suitably amending section 19(5) of the Foreign Exchange Regulation Act.

It is also worth mentioning in this connection that the storm raised over the transfer of shares bought by a London based group of companies in the shares of two leading Indian companies, which is now part and parcel of the Indian corporate history, has also raised some fundamental questions like the free transferability of shares bought on a Stock Exchange, etc.

The Government of India is no doubt seized of all these matters and with the ongoing process of liberalisation of policies and simplification of procedures, things have considerably improved in the recent years. It is worth observing in this regard that there is a definite move towards globalization of Indian markets. Recently, the Indian Prime Minister, Mr. V.P.
Singh, while addressing the World Economic Forum stated that India intended to participate fully in the gradual process of global integration and inter dependence through trade, technology and investment. He had also stated in the same address that the Government was also considering ways of making the foreign investment policy more transparent and of ensuring speedier decisions. Already, the new industrial policy announced on the 31st May, 1990 has removed clearance requirements for foreign investment upto 40 per cent in the approved areas.

3) Falling Value of Indian Rupee:

Fast depreciation of Indian rupee in recent years has also played an important role in diversion of NRI funds away from the Indian markets. While in the short run, rupee may be going down in value, with the Indian economy poised for a take off during the nineties the rupee may hold its place in the years ahead and, therefore, investment in Indian securities may prove beneficial in the long run.

The decision recently taken by the Reserve Bank of India providing for refund of excess application money at the same original rate of foreign exchange at which it was remitted deserves special mention in this connection. What, however, is annoying the investors is the malpractice indulged in by a number of companies of despatching refund orders after the 70th day from the date of closure of the subscription list without payment of interest at the stipulated rate of 15 per cent for the delayed period beyond the 70th day till the date of despatch.

4) Fiscal Concessions:

The fiscal concession of 20 percent tax both on dividend and long-term capital gains extended to individual non-resident Indians is, however, not extended to overseas companies predominantly owned by non-resident Indians. They continue to pay at the higher rate of tax of 25 percent on dividend income and 45.5 per cent on long-term capital gains. This seems to have been mainly responsible for low level of interest by such overseas companies for investment in the Indian securities market. Government is well advised to look into this aspect so as to encourage such overseas companies to evince better interest in the Indian stock market. In order to ensure that there is no misuse in this regard, it can be stipulated that the concessional rate of taxation will be granted to only such corporate entities which are owned by non-resident Indians to the extent of at least 90 per cent.

5) Removal of One Per Cent Ceiling:

The low level of interest evinced by the non-resident Indians has virtually resulted in none of them touching anywhere the ceiling of one per cent of the paid-up capital of the company. The question of removing this ceiling, atleast from the point of view of dismantling a psychological barrier, needs favourable consideration. Alternatively, the question of issuing shares above one per cent without voting rights can be considered.
Prospects Ahead

Notwithstanding certain adverse factors prevalent today, the Indian stock market offers some of the best opportunities on global scales for stock investment. International fraternity is already looking out for the ways and means to participate in the future prospects of investment in India. This is because of the following factors:

1) Indian economy is poised for a sound and well diversified growth in the years ahead. Already the growth rate has climbed to above 5 per cent during the 7th plan.

2) There is a well planned policy of liberalisation which is being pursued by the Government.

3) The burgeoning Indian middle class ensures a virgin and untapped market, far greater in size than any other market in the world, which can be tapped for a vast magnitude of products and services. In fact, the living style of about 100 million people is already said to be on a scale comparable to that of the developed economies.

4) Indian industries are growing at a much faster rate, the average during the 7th plan being more than 8 per cent, and are diversified on a wide spectrum. Moreover, there is a greater free play for the private sector in areas such as power and steel which were hitherto an exclusive reserve for the public sector.

5) Indian stock markets are vibrant and poised for a quantum growth during the years ahead. Moreover, the price-earnings ratios historically languished at conservative low-levels for several reasons, have, of late, shown signs of improvement. These will improve further with greater securitization of Indian economy and expansion in the private sector activities. A particular noteworthy factor is that while equities rose on an average by a mere two per cent in the 60s and by 60 per cent in the 70s, the rise in the 80s was over 260 per cent and this tempo is expected to be maintained in the 90s. Equally important is the fact that the Indian stock markets are well regulated and behaved in an orderly fashion during the hectic days of eighties. There is a move towards greater automation and transparency in the stock market. The Bombay Stock Exchange has already taken a lead in the matter. Instant trade capture, real time display of information and on-line processing of transactions through a mainframe computer will become operational hopefully by the end of 1991. This may eventually lead to trading through screens without the trading rings as in the case of London, Singapore and elsewhere. Efforts are also on to move towards a certificateless society. A two-stage journey is envisaged for this purpose. Initially, the securities will be immobilised in depositories. A Stock
Holding Corporation which is dealing with the securities of Financial Institutions has already been established. The Bank of India in collaboration with the Bombay Stock Exchange has also established BOI Shareholdings Ltd. to deal with the securities handled by the stockbrokers. In the second stage, securities will be dematerialised with holdings being accounted as in the banking system and as already developed by countries like Norway, Denmark and France. Protection of investors is of paramount importance for the Indian market authorities and regulators and the rules and procedures are being regularly amended to impart greater protection to the investors. Customers Protection Funds are being established at most of the Stock Exchanges in the country.

Thus, the Indian securities markets offer some of the best opportunities available for investment of which the NRIs should take early advantage of, given the special facilities accorded to them.

INDIAN CAPITAL MARKET DURING NINETIES

BY

Shri M.R. Mayya
Executive Director
The Stock Exchange, Bombay

Eighties was a decade of monumental changes on the Indian capital market leading to a total revamp of its position and exponential growth in activities. The decade has, therefore, been rightly called the decade of capital market as the developments therein during the decade were unparalleled and unmatched by happenings in any other segment of the economy. As a result, the capital market of the country became the synosure of all eyes in the country and to some extent of the globe too. It has, however, to be said to the credit of all concerned and more so to the resilience of the system that the growth syndrome and the other profound changes that had taken place were smoothly absorbed in the mainstream without creating any major problems or hindrances in the operations of the market.

Growth During Eighties

The growth of the market is reflected in various indicators available. For example, the annual capital mobilization towards the end of seventies was barely one billion rupees a year. This witnessed a seventy fold rise with the estimated capital mobilization during 1989-90 exceeding Rs. 70 billion. During this period, market capitalisation also shot up from about Rs. 35 billion to over Rs. 900 billion in October 1990 accounting for about 20 per cent of the GNP now as against about 3 per cent ten years ago. Similarly, the daily turnover on the Bombay Stock Exchange, which was of the order of about Rs. 10 million in late seventies has grown to over Rs. 2 billion a day on several days during the current year. The investor population in the country has increased from a low figure of about 2 million towards the end of seventies to a respectable level of 15 million at present.

Impressive as the above quantitative figures are, what is of greater significance is the extent of qualitative changes in the character of the market. The corporate sector did not depend much on the stock market for mobilisation of resources and was dependent on the financial institutions for loan funds. The decade of eighties changed that scenario with not only the private sector but even the public sector increasingly tapping the stock market to raise the necessary financial resources. Entry of a number of mutual funds in a big way towards the close of the decade ushered in a new class of investors not possessing the requisite expertise to understand the mechanics of direct investment in stock market instruments to reap the benefits of the stock market activities by investing in these funds. Again eighties was the first decade in the history of independent India which saw stock investments act as more than a hedge against inflation. Media which also paid greater attention to the stock market developments helped in increasing investor awareness of the market. Market authorities and regulators also initiated during the decade several
measures to improve the quality of the market and to ensure greater safety for the investors. All these steps helped in altering the concept of stock market activities from that of a casino to one of constructive economic activity, part and parcel of the overall development process of the economy.

**Nineties A Decade of Investor Protection**

While eighties was an exciting decade given its greater emphasis on growth, nineties will lead to a more qualitative transformation in the market with growth being a more natural phenomenon. It will necessarily have to be a decade of investor protection as the emphasis will be rightly on improving the quality of services rendered to the investors who supply the requisite funds for the growth of the market. It will be fascinating to peep into the future and envisage the likely changes that are expected to take place during the nineties which will help in the emergence of the capital market as a vibrant instrument of growth by the time we enter the twenty-first century.

**Industrial and Economic Liberalisation**

Indian economy, prior to the eighties, was more a controlled economy with emphasis on the public sector attaining the commanding heights of the economy and the private sector playing a secondary role with several and often severe controls, physical and otherwise. The decade of eighties has, however, witnessed a gradual change with the private sector being given greater freedom of operation and being allowed to operate even in the core sector of industries which was hitherto an exclusive preserve of the public sector. While presenting the 1990-91 Budget, the Finance Minister has proposed equity participation by employees in the public sector undertakings, which may well prove to be a step towards at least partial privatisation of the public sector. The more liberalised environment for the private sector growth and the prospective privatisation of the public sector will obviously lead to greater securitisation of the financial investments.

**Growth Projections for Nineties**

During the nineties, the number of companies listed on the Stock Exchanges will rise from a little more than 6,000 to more than 10,000 with a paid up capital of all listed securities whether equity or preference shares or debt securities rising from about Rs. 250 billion to the tune of about Rs. 1,000 billion. The market value of listed equity is also expected to shoot during this period to over Rs. 3000 billion constituting at least 30 per cent of the gross national product. Annual capital mobilisation on the stock market will also zoom to over Rs. 200 billion by the time we enter the twenty-first century while the daily turnover will increase to over Rs. 10 billion on the Bombay Stock Exchange alone as the markets become more active. The number of stock market investors will increase manifold over from their present strength of 15 million to about 50 million with the number of shareholders in the country being close to those in U.S.A. which has the highest shareholding population in the world.

Such a growth in the overall market activity will naturally necessitate a more easy
access to the market for investors from any corner of the country through increase in the number of stock exchanges. Around 40 stock exchanges are expected to be functioning right across the country by the time we come to the end of this century as against 19 stock exchanges at present. In parallel, the number of brokers on the stock exchanges will also increase. With multiple membership and improved communication facilities, a national market system will emerge with the buyers and sellers in any part of the country being able to buy and sell at the best prices prevailing in any market in any part of the country.

At present, there is a very narrow spread of market instruments with only equity and preference shares, convertible debentures and bonds, convertible either partly or fully, and non-convertible debentures. The monopoly in respect of mutual funds enjoyed for a long time by a single institution has been broken. There are today a number of mutual funds, but all in the public sector, offering to the investors a wide choice of investments. Warrants and zero interest bonds have also recently made their appearance while cumulative convertible preference shares have proved to be non-starters. Moreover, secondary market trading is confined mostly to equity and equity related instruments. It has become imperative that the number of instruments available for investments will have to be further broad based so as to cater to the needs of different investors and help at the same time the corporate sector to tap the market in the most economic manner. It can reasonably be expected that the field of mutual funds will be thrown open to the private sector which will stiffen the competition among the mutual funds hopefully resulting in better returns to the investors. Trading in options and futures which are prohibited at present may also have to be permitted so as to make the market full fledged and complete in respect of the investment instruments.

**Ringless and Paperless Trading**

The overall volume of trading is set to grow exponentially during the years ahead. However, the time taken for settlement of these transactions will go down sharply as the various measures taken for the purpose become stabilized and fully operational. At present, it takes even up to 30 days if not more, for an investor to receive shares purchased or proceeds of shares sold. Hopefully, this time will be reduced significantly with the stock exchanges switching over to automation and computerisation. The Bombay Stock Exchange has taken a lead in this regard and has launched its computerised trading and settlement plan. This plan which will become operational in stages from the middle of 1991, envisages restriction of floor trading for 150 highly active stocks while all other stocks will be transacted through the screen and once this is accepted by the brokers and the investors, in all eventualities, trading ring may become obsolete and may have only a sentimental value by the turn of the century with stocks being traded in a far greater volume than hitherto through the screen. Computerised or screen trading will also lead to an online settlement system as against the batch system prevalent today and can ensure reduction in the settlement period and even a possibility of a rolling settlement. As a result, stock instruments will become more liquid and realisation of transactions proceeds will be much faster. More importantly, computerised or screen trading and online settlement will help the exchange to monitor the market more efficiently and as a result corrective action can be taken on real time basis so as to avoid occurrence of crisis.
Along with a move towards ringless trading, there is a parallel development towards the paperless and certificateless society. The present system of dated transfer deeds and physical transfer of shares is an archaic system and has proved to be a major hindrance for the efficient performance of the market. It is necessary that instruments be immobilized in depositories initially and later be totally done away with, so that we move on to a certificateless environment as has already happened in some of the countries like Norway, Denmark and France and as is being planned by the United Kingdom under their TAURUS (transfer and automated registration of uncertificated stocks) system.

The Bombay Stock Exchange in its efforts to promote such an environment has already floated a company called BOI Shareholdings Ltd., to, inter alia, act as a depository for members of the exchange in the first instance and for investors at large later in a phased manner. A depository to handle the shares of financial institutions has already become operational. A string of such depositories spread all over the country or an amalgam of them under one single umbrella will eventually lead to immobilization of certificates and more efficient operations on the stock market.

This is only a first stage of the move towards a certificateless society. A proposal to establish a Stock Holding Corporation (SHC) to replace the present system of certificates and transfer deeds was submitted by late Mr. P.J. Jeejeebhoy, Chairman of the Bombay Stock Exchange, way back in 1979. According to this proposal, a Central Stock Holding Corporation is to be set up on a statutory basis with regional and area offices at all centres where there are stock exchanges. The State Bank of India and its subsidiaries and the nationalised banks with their branches all over the country would act as agents of the SHC. The SHC would be the sole central depository of securities acting as an agent simultaneously for and on behalf of investors and listed companies.

The mechanics of operation of this proposal would require each shareholder in the country to have an account with the proposed SHC. The shares purchased by him would be credited to his account while the shares sold by him would be debited to his account. When an investor buys the shares of a company, his broker would send him a Delivery Order for the shares bought. The investor would then fill in a Deposit Slip, attach it to the Delivery Order and hand them over to his bank. The bank would transmit the same to the SHC for crediting the investors’ account with the shares bought. Similarly, when an investor sells, he will issue a Delivery Order to his broker. The broker would either deposit the Delivery Order in the account of the seller with the SHC or endorse it to the buying investor who would deposit it in his investment account with the SHC. The SHC would then debit these shares to the account of the seller investor and credit the same to the account of the buyer investor. An investor’s account with the SHC would thus be credited and debited from time to time with the shares he has bought and sold. No share certificates or any transfer deeds would be involved. Each listed company will maintain with the SHC an account showing the shares held by its shareholders which will act as the Register of Members of the Company.
Investor Protection

Increasing complexities of the market make it more imperative that the investors be given complete protection. Investors often suffer loss for no fault of theirs when a stockbroker defaults. Strange as it may sound, in case of a default by a stockbroker, clients of the stockbroker are left high and dry as the net available assets of the defaulter go to meet the claims of the stock exchange in the first instance and of his market commitments there after, leaving virtually nothing for the clients. To mitigate such losses and to protect investors, the Bombay Stock Exchange had launched a Customers' protection fund in 1986. Presently, investors are paid compensation subject to a maximum of Rs. 10,000 against their genuine investment claims whenever a broker is declared a defaulter. The scope of this fund needs to be expanded further to ensure immunity to the investors to the extent of at least Rs. 1,00,000, if not more, on the lines of similar funds in the developed markets of the world.

Stricter Regulation

The growth of the market in the 80s has unfortunately not been accompanied by a concomitant growth in the regulation of the market. Even countries like United States and U.K. where laisser-faire is practised to a greater extent in matters of licensing of industry and trade than in most other market oriented economies, the securities industry is subject to a very strict code of regulation. This is absolutely necessary in this country, particularly in the light of what happened in the mid 80's when a number of fly-by-night operators mopped up the hard earned savings of the gullible investors and a more or less similar experience was witnessed in respect of the mega issues towards the end of the last decade. A strong regulating body to oversee the entire securities industry and which will be respected like the Securities and Exchange Commission in the United States, is absolutely necessary in this country. It is only then that the concept of changing the law from caveat emptor (buyer beware) to caveat vendor (seller beware) adumbrated by President Franklin D. Roosevelt while signing the Securities Act of 1933, can be said to have became applicable in this country.

Integration with the World System

Indian stock markets are at present insulated from the global forces and access to foreigners is restricted to only non-resident Indians. This was necessary earlier because of the exigencies of time. However, fast growing communications systems and transnational economic involvements have turned the world into a large sized economic village. Events taking place in Europe such as more freedom for market forces in the East European countries and the proposed unification of Europe in 1992 will have major impact on the
global economic scene from which India cannot remain aloof. It may, therefore, be necessary for Indian markets also to open up and to integrate with the global systems. The Prime Minister has recently indicated that India intended to participate fully in the gradual process of global integration and interdependence through trade, technology and investment. Already a small beginning has been made in this regard through country funds floated overseas whose resources will be invested in the Indian stock markets. This will gather further momentum and should gradually lead to an open Indian market fully integrated with the international economic system.

Indian stock market scenario thus will undergo a thorough transformation during the coming decade and it will be a captivating transformation worth watching and participating as the Indian market is poised to emerge as a major international market in the near future bridging the wide gap between Tokyo in the East and London in the west.

INDIAN STOCK MARKETS

by

M. R. Mayya
Executive Director
The Stock Exchange, Bombay

India has a well developed capital market system, by far one of the best in the developing world. It comprises term-lending institutions or development financial institutions like the Industrial Development Bank of India, Industrial Finance Corporation of India and Industrial Credit and Investment Corporation of India Ltd., which provide long-term debt capital to the industry, investment financial institutions like the Life Insurance Corporation of India and the Unit Trust of India which also provide long-term finance, commercial banks which are also involved in providing long-term finance, a plethora of State-level development and investment-oriented institutions and more recently venture capital funds providing finance to greenfield ventures involved in high-tech industries. Equally important is the fast growing stock market activity which has witnessed unprecedented growth in the 80s. It is proposed to deal in this article with the stock market activity which currently provides for bulk of the long-term finance of industry and trade.

Indian Economy

The capital market works in the given economic industrial milieu. Indian economy for over three decades after independence was dominated by the public sector which was considered as the major vehicle for economic and industrial development. The trend has, however, changed since the mid-80s with liberalisation of Government policies and greater freedom given to the private sector in most of the sectors, including the basic sector comprising iron and steel, power and road construction, among others. The policy of progressively deregulating the economy has more than anything else led to the emergence of stock markets as a major instrument of finance for industry and trade.

The Indian economy during the 80s is growing at a much faster rate and the average annual growth rate during the 80s was 5.5% as against the almost stagnant annual average growth rate of 3.5% witnessed for the earlier three decades. Equally important is that the savings ratio in the economy is very high. Gross domestic savings as a percentage of gross domestic product zoomed more or less progressively from a low level of 10.2% in 1950-51 to 23.2% in 1978-79 and has been stagnating around 20% thereafter. India is thus blessed with a growing pool of savings currently of the order of about one trillion rupees i.e., about $ 56 billion.

Industry has been growing at significant rate of about 8% in the 80s as against 5% in the earlier decades. The driving force for the industrial growth is a large and growing

@ Talk delivered in Hong Kong on 4-13-90 in the Seminar on "Asia's Emerging Markets" organized by Indosuez Asia Investment Services Ltd., Hong Kong.
domestic market accounting for about 94% of aggregate demand basically emanating from a thriving class of about 150 million people with standards of living comparable with their counterparts in developed economies. The rising expectations of the other 680 million people tend only to accelerate this demand.

The agricultural sector, which dominated the economy for a long-time, no more does so. The overall dominance of the primary sector comprising agriculture and mining has come down while secondary and tertiary sectors are having a greater share of the economic activity. Time series data presented in Annexure I reflects the changing share of the three sectors since 1970-71. While the shares of the primary sector in the net domestic product declined from 50.1% in 1970-71 to 36.15% in 1988-89, that of the secondary sector rose from 19.7% to 25.54% and of the tertiary sector from 30.2% to 38.31% during the same period.

Growth of Stock Exchanges

India can boast of being one of the oldest stock markets in Asia. Nearly 200 years ago, trading in securities used to take place. The first stock exchange, however, came to be established in 1875 in Bombay when the stockbrokers, aghast at their plight following the severe depression in securities industry, decided to form "an association for protecting the character, status and interest of native share and stock brokers and of providing a hall or building for the use of members of such an association". The process of establishment of stock exchanges gradually spread to other cities of the country like Ahmedabad, Calcutta, Madras, etc. As a result, in the initial years of regulation of the Securities Contracts (Regulation) Act, 1956 - the first all-India legislation regulating the stock exchanges in the country - there were eight recognised stock exchanges in the country. For nearly two decades thereafter, the number virtually remained unchanged. The decade of eighties, however, saw the birth of a number of new recognised stock exchanges in the country and there are at present 19 recognised stock exchanges spread as far as Ludhiana in the north, Cochin in the South, Guwahati in the East and Rajkot in the West. With the cult of equity spreading fast to the four corners of the country, prospects of many more stock exchanges springing up in the country are bright and there could easily be over 40 stock exchanges humming with activity all over the country by the end of the century. The argument by a section that establishment of more stock exchanges is not conducive for the development of efficient systems of functioning of the securities industry ignores the fact that the communication facilities in the country are not satisfactory and also that a direct and close regulating authority easily accessible to the investor inspires confidence in investment in stock market instruments.

Number of Shareholders

The growth in the number of direct shareholders in the country has also been phenomenal during the last one decade. It has grown steadily from about a million or so about ten years ago to about 12 million currently. The country has thus the second largest shareholding population in the world next only to United States of America which has about 50 million shareholders and subscribers to mutual funds and significantly ahead of
countries like Japan, United Kingdom and France, all with a population of about 10 million. With about 2 to 3 million new shareholders joining every year, in absolute term, India can perhaps boast of having the largest shareholding population in the world in the first decade of the next century. 50 million shareholders estimated to be in the country by the end of the century would constitute only 5% of the population.

The country has also a large number of debentureholders whose figure can currently be estimated to be about 5 million. These also add to the stock market activity. Most of the debentureholders are prospective shareholders as they hold convertible debentures awaiting conversion into equity shares. Non-convertible debentures, holders of which may not exceed one million, are still not very popular in this country as the rate of interest is pegged generally at the maximum rate which currently is 14% per annum. The concept of a freely floating rate of interest on debentures is still not accepted in this country.

Membership of the Stock Exchanges

With the increase in the number of stock exchanges, the number of active stockbrokers has also increased during the last one decade. There are today over 3,000 active stockbrokers all over the country as against about 1,250 about ten years ago. Stockbrokers are also encouraged to amalgamate themselves into corporate entities for which the statute was specially amended in July, 1987. This has not produced the requisite degree of response. There are at present hardly about half a dozen corporate entities in the country which have had recourse to these provisions mainly perhaps because these provisions need a minimum of two persons to be members of a stock exchange in their individual capacity for a corporate membership to be formed. Alternative ways of formation of corporate membership with a single membership, perhaps in the name of the corporate entity itself is presently under consideration of Government.

The amendment to the statute effected by Government in July, 1987 also provides for admission of financial institutions and their subsidiaries and subsidiaries of banks in the public sector to be admitted as members of stock exchanges on their being so recommended by the Government of India. Although some of the stock exchanges have enrolled them as members, the Bombay Stock Exchange, which is the premier stock exchange in the country, has not yet accepted them as members. The proposal put forward by the exchange to have a code of conduct and mode of operation for these entities with a view to creating additionality of services like going into semi-urban and rural areas where the equity cult needs to be nourished, market making, etc., was not accepted by the Government. The general body of the exchange whose sanction is necessary for increase in the strength of membership of the exchange has deferred a decision in this behalf. While no doubt these entities will eventually have to be permitted to become members of the Bombay Stock Exchange, it is pertinent to note that this does not mean that the country is accepting the concept of "universal banking" as is the practice today in most of the European countries, as stockbroking firms would continue to be barred from entering the field of commercial banking.
The requirement to become a stockbroker is still confined to a nominal monitory security deposit, which in the case of Bombay Stock Exchange, is a meagre Rs. 0.20 million while at other stock exchanges the deposit prescriptions are still lower. Price of the card of membership, which is currently over Rs. 3 million at the Bombay Stock Exchange, however, acts as a safety wall against any likely defaults. The concept of net capital requirements relating business with the capital of a firm has still not been introduced although margins of varying types related to outstanding business at any point of time in the forward segment of the market do no doubt try to limit the business of a firm to its financial capacity.

Applicants for the membership of stock exchanges do not still have to pass any examination relating to the securities industry. In fact, excepting at the Bombay and Calcutta Stock Exchanges, where some limited training facilities for stockbrokers are available, there is no institute catering to this requirement. It is, however, heartening to observe that several of the new entrants to the stockbroking business are highly qualified persons, being chartered accountants, company secretaries and MBAs. They are lured into this business because of the tremendous financial gains that can be made. Even these qualified persons need to be trained as intricacies of the securities industry are not part of their curriculum of studies. Prescription of qualifying examination to be a stockbroker is, therefore, under consideration of the authorities.

**Governing Board of Stock Exchanges**

In tune with the developments the world over, complexion of the governing boards of Indian stock exchanges too is undergoing a change, with more of non-broker directors being inducted into the board rooms of the stock exchanges. Presently, non-broker directors who are generally representatives of the Ministry of Finance, Department of Company Affairs, financial institutions and Securities and Exchange Board of India - the newly formed watch-dog of the securities industry - and some leading personalities drawn from different professions like chartered accountancy, law, etc., constitute about one-third of the strength of these boards. Most of these non-broker directors have made significant contributions in the deliberations and policy making processes of stock exchanges and are no longer considered to be aliens in these forums. There is latterly a realisation in informed quarters that their strength needs to be increased to about one-half of the size of the boards, as is normally the pattern in most of the developed markets of the world.

What is particularly significant is that the non-broker directors are nominated either directly by Government or with their approval which doubly ensures that they always act in the public interest. Even the presidents and vice-presidents at most of the stock exchanges are also nominated by Government from among the elected stockbroker directors.

Day-to-day administration of stock exchanges is entrusted to executive directors at several of the stock exchanges appointed with the approval of Government. There is a move to appoint executive directors at all the stock exchanges so that the day-to-day administration is not looked after by elected stockbroker presidents, not all of whom may always be
able to rise above partisan and sectional interests. Powers of the executive director at the Bombay Stock Exchange are almost concurrent with those of the governing board and the question of clothing the executive directors at the other stock exchanges with similar powers is under consideration.

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

**New Issues Market**

Private corporate sector did not show much enthusiasm to offer capital to the public till 1980, because of (i) generally small size of the operations and narrow capital base, (ii) availability of loan capital on easy terms from the term-lending institutions, and (iii) fear of losing control over the company. The decade of 80s, however, witnessed a sea change in the mobilisation efforts of stock markets as more and more companies propelled by the policy of deregulation by Government entered the market to raise their funds. Investors on their part after the gainful experience of investing in public offerings of FERA companies during the latter half of 70s were also more receptive to invest in the stock market securities. As a result, annual capital mobilisation in the new issues market which was only to the tune of about Rs. 700 million in 60s and Rs. 900 million in 70s has increased manifold during the 80s with the amount raised in 1989-90 being of the order of Rs. 61.5 billion i.e. about $3.58 billion. Annexure II gives the capital mobilisation from 1960-61 to 1989-90.

It is worth noting that while only 10 years ago, the total capital mobilisation in a year was about Rs. one billion, there were eleven issues each individually raising more than Rs. one billion during 1989-90. These mega issues, as they are popularly called, did create quite a bit of controversy in the country. Government has already taken suitable corrective measures by directing that in respect of all issues of Rs. 500 million and above (i) proceeds from the issues be used strictly for the requirement of the projects/activities mentioned in the application for approval and not for any other purpose, (ii) the proceeds to be invested only in fixed duration deposits/instruments with the cooperative/nationalised banks, Unit Trust of India, financial institutions and public sector undertakings till they are deployed in the proposed activities, (iii) monitoring of the use of funds by some financial institutions like the Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, etc., and (iv) the amount to be called as 25% on application and the remaining 50% in two or more calls after the monitoring institution is satisfied about the use of funds already collected. Government is also now more realistic in grant of premium to further issues. While these correctives were no doubt called for, mega issues indicate the dynasism of the Indian capital market. It is no more a small market; it is broad and wide market easily capable of generating bulk of the funds required by the private corporate sector. Currently about 40% of the capital is met by this market.

Equities continue to be the main stay of the market. However, in recent years, convertible debentures which are converted into equities either fully or partly are becoming
more popular and during 1989-90 they accounted for about 73% of the capital raised during the year. Non-convertible debentures, which in the first half of 80s, were popular with the investors because of the progressive rise in the rate of interest on these debentures from 10.5 in 1977 to 15% in March, 1985 but subsequently scaled down to 14%, are now invoking only lukewarm response from them. These are now being subscribed mostly by mutual funds, financial institutions, Army Pension Funds, etc.

Cumulative Convertible Preference Shares - an instrument giving regular returns at 10% during the gestation period from three years to five years and equity benefit thereafter - introduced by Government in 1984 has, however, failed to catch the investors' interest mainly because the rate of return was considered to be too low in the initial years and the provision for conversion into equity also unattractive if the company failed to perform well.

Of late, zero coupon bonds and convertible warrants are two new instruments that have been floated by certain companies. Their overall impact and popularity will be known only during the years ahead.

Of late the average size of capital floatation is showing a significant increase. During 1989-90, the average size of the equity issue was Rs. 52.7 million as against Rs. 4.9 million in 1979-80. The average size of debenture issue also has similarly gone up to Rs. 380 million during 1989-90 from Rs. 7 million in 1979-80. This has happened because of reasons like companies under the present liberal conditions being encouraged to go in for minimum economic size projects, capital intensity of the projects having increased, companies turning more and more to the stock market to mobilise their funds, etc.

Listing in Indian stock exchanges is comparatively easy. A company seeking enlistment must have a minimum capital of Rs. 30 million and make a public offer of 60% i.e., Rs. 18 million. The requirement of 60% of public offer can, however, be relaxed in the case of companies with foreign equity participation, joint sector companies, companies with non-resident Indian equity participation, established Indian companies (i.e., companies incorporated in India at least ten years prior to the date of listing application or companies with a profit-earning record for at least four years out of five years prior to the date of the listing application), etc.

The listing requirements also stipulate, inter alia, that the subscription list should be kept open for at least two working days and that the provision for collection of applications be made at certain designated centres in the country numbering in 57 which have stock exchanges or which are heavily populated. The former requirement is acting as a major cause for heavy oversubscription in popular issues which in quite a few cases has been more than 20 times. The latter requirement is proving to be a hindrance for speedy allotment of securities which statutorily has as many as 70 days from the date of closure of the subscription list to be complied with.

The listing requirements have not prescribed any previous track record for getting the shares listed on any stock exchange. This practice was adopted mainly with a view to
encouraging companies to get their securities listed on the stock exchanges. Fiscal incentives by way of exemption of income to the extent of 50% of the subscription upto Rs. 20,000 are granted to compensate for any likely loss to the small investors due to non-declaration of dividend by companies during the gestation period.

New issues of brand new companies have to be offered to the public for subscription at par value. Further issues of existing companies doing well can, however, be offered at a premium, the quantum of premium being fixed by the Controller of Capital Issues under the Capital Issues (Control) Act, 1957. This is basically fixed on the basis of book value and profit-earning capacity of the company normally capitalised at 15% and relating it to the market price of the share. Free market forces are not allowed to fix the premium because of apprehensions of manipulation of prices at the time of offer so as to load the share on the market with a higher premium and the absence of any effective punitive provision in the Indian laws against manipulation. The premia granted in recent years, however, appear to be quite realistic, being neither too high nor to low.

A significant feature of the Indian stock markets is that the listing requirements are uniformly applicable to all the stock exchanges in the country, be it the premier stock exchange of the country at Bombay or the near dormant stock exchange at Indore in the heart of the country.

Disclosure about New Issues

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

In order to enable the potential investors to take a well informed decision in the matter, the Companies Act, 1956 spells out in some detail the information to be given in a Prospectus/Letter of offer, Schedule II of the Act sets out the matter to be included in the Prospectus/Letter of Offer which covers, inter-alia, the history and business of the company and of its promoters and management, particulars of the projects including its costs and means of financing, business prospects, status and profitability, audited accounts for a period of five years preceding the issue of the Prospectus/Letter of Offer with the gap between the date of latest accounting year and the date of issue of Prospectus/Letter of Offer being not more than 120 days, material contracts, particulars of the securities to be issued, information about the issue, etc. Furthermore, to ensure that the information required to be stated in a Prospectus/Letter of Offer is truthfully disclosed, the Act prescribes severe penalties, civil and criminal, for untrue statements in a prospectus. These provisions also apply to brochures, pamphlets and other publicity material advertising the issue of securities. Unfortunately, the safeguards provided against prosecutions are so wide that hardly any worthwhile case has so far been instituted against untrue statements. The recent decision taken by the government that while directors, promoters and every person who authorises the issues of prospectus shall bear full responsibility for the contents of the prospectus, merchant bankers shall exercise due diligence independently varying the
contents of the prospectus and reasonableness of the views expressed therein and certify to this effect to the Securities and Exchange Board of India is, however, expected to improve the system.

In fact, the problem about the prospectus is not with regard to untrue statements but about inadequate disclosure of material facts and risks. Many of the issue highlights, like 'latest or proven technology', 'assured market', 'low breakeven point', 'assured dividend' that allure unwary investors require adequate substantiation. Various factors that should guide a prospective investor in making investment decisions like existing and expected market for the product of the company, market competitors and their performance, anticipated performance/contribution expected from the project, risks associated with project, etc., are all ignored. These factors necessitate widening the scope of disclosures in prospectus so that an investor has sufficient data to analyse the prospectus and risks involved in investing in a company. Further projection, together with details of all material assumptions thereto, could be added provided such projections are vetted by financial institutions appraising the project and the merchant bankers acting as managers to the issue and licensed in this behalf by the Securities and Exchange Board of India.

The investor decision is unfortunately based more on pamphlets, circulars and other publicity material that are circulated by various brokers and investment agencies. The guidelines issued by government that the company entering the capital market prepares a plain matter of fact explanatory statement based on the prospectus and no other literature other than this plain matter of fact explanatory statement is not strictly adhered to.

Perhaps the most important influence in investment decision is that based on the newspapers and more particularly investment magazines and periodicals. All sorts of unsubstantiated claims and projections are given in the media about a company's future prospectus and working which has an undue influence on innocent investors. Suitable corrective measures in this behalf are on the way.

Absence of a track record for being eligible to be listed on a stock exchange has emboldened quite a few entrepreneurs to take advantage of listing by floating companies, which do not otherwise merit listing. Grant of fiscal incentives, by way of lower tax rates to listed companies - the present rates being 40% for all listed companies as against 45% for a non-listed manufacturing company and 50% for a non-listed investment and business company - has also encouraged this trend.

With a view to protecting the interest of genuine investors, Government have been trying to plug this loophole. A scheme to subscribe for the shares of new companies with a capital up to Rs. 10 million was announced by Government in December, 1986. Institutions like the Industrial Development Bank of India, SBI Capital Markets and Canbank Financial Services are nursing such projects. Shares of these companies will be put on the market later when these companies attain the dividend-paying stage.
Government of India have also come out with guidelines for floatation of Venture Capital Funds, establishment of which is encouraged by grant of fiscal incentives. The minimum size of a Venture Capital Fund has to be at least Rs. 100 million, the promoters being required to subscribe for not less than 40% of the same. Venture capital assistance from this fund for small and greenfield Companies with a total investment of not more than Rs. 100 million can be granted. A number of institutions like the Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India, SBI Capital Markets, Canbank Financial Services, foreign banks like Grindlays, State Government agencies like Andhra Pradesh Industrial Corporation and State Industrial Investment Corporation of Maharashtra, and private sector units like Credit Capital Finance Corporation have all recently set up Venture Capital Funds. This is gradually having its impact on the capital market with quite a few first generation entrepreneurs taking advantage of the resources from these Funds.

Yet another significant step in the new issues market is the establishment of Credit Rating and Information Services of India Ltd. (CRISIL) in 1988, promoted by Industrial Credit and Investment Corporation of India Ltd. and Unit Trust of India. CRISIL is currently rating debt-obligations of Indian companies like debentures and fixed deposit schemes, preferential shares and short-term instruments like commercial paper. Although this is still on a voluntary basis, a growing number of companies are availing of the services of CRISIL as it facilitates marketing their issues. As on the 30th June, 1990, 13 debentures, 14 fixed deposit schemes and 19 commercial paper programmes of 28 manufacturing companies and 21 fixed deposit schemes and 2 commercial papers of 21 finance companies, involving a total amount of a little over Rs. 5 billion, have already been rated.

The relatively high level of issued capital required for a company to be eligible to be listed in a stock exchange has prompted the Government of India to grant recognition to Over-The-Counter Exchange of India (OTCEI) under the Securities Contracts (Regulation) Act. OTCEI has been promoted by Unit Trust of India, Industrial Credit and Investment Corporation of India Ltd. and others. OTCEI will basically be a screen-based market makers, who will have to be members of the OTCEI, continuously giving two-way quotations. A company can get the benefit of listing by offering even 10% of its issued capital to the public. OTCEI is expected to be operational early next year.

Number of Listed Companies

The relatively less stringent conditions have led to emergence of a large number of listed companies in the country. There are at present over 6,000 companies listed on the various stock exchanges in the country. India thus occupies the second position in the world next only to the United States of America which has about 7,00 listed companies. What is, however, required to be noted is that the paid-up capital of about 40% of these companies is less than Rs. 10 million. Frequency distribution of paid-up capital of companies listed on the Bombay Stock Exchange which accounts for about 85% of the paid-up capital and about 90% of market capitalisation is given in the following table:
<table>
<thead>
<tr>
<th>Category</th>
<th>No. of Companies</th>
<th>Percentage to Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than Rs. 5 million</td>
<td>529</td>
<td>21.8</td>
</tr>
<tr>
<td>More than Rs. 5 million and Upto Rs. 10 million</td>
<td>405</td>
<td>16.7</td>
</tr>
<tr>
<td>More than Rs. 10 million and Upto Rs. 30 million</td>
<td>805</td>
<td>33.2</td>
</tr>
<tr>
<td>More than Rs. 30 million and Upto Rs. 50 million</td>
<td>262</td>
<td>10.8</td>
</tr>
<tr>
<td>More than Rs. 50 million and Upto Rs. 100 million</td>
<td>228</td>
<td>9.4</td>
</tr>
<tr>
<td>More than Rs. 100 million and Upto Rs. 250 million</td>
<td>141</td>
<td>5.8</td>
</tr>
<tr>
<td>More than Rs. 250 million and Upto Rs. 500 million</td>
<td>35</td>
<td>1.4</td>
</tr>
<tr>
<td>More than Rs. 500 million and Upto Rs. 1 billion</td>
<td>17</td>
<td>0.7</td>
</tr>
<tr>
<td>More than Rs. 1 billion</td>
<td>6</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,428</strong></td>
<td><strong>100.0</strong></td>
</tr>
</tbody>
</table>
Market Capitalisation

Indian stock markets wore a lacklustre outlook till the decade of 80s basically because equities failed to act as a hedge against inflation while other avenues of investment like gold and silver, real estate, etc. proved to be safe heavens against the rising prices. During the sixties, the index number of ordinary shares, as compiled by the Reserve Bank of India, rose by a meagre two per cent while in the seventies the rise was more modest being of the order of about 60 per cent while the rise in the index number of wholesale prices during these two decades was of the order of about 80 per cent and 160 per cent respectively. The decade of 80s witnessed the rise in the Reserve Bank of India index of ordinary shares shooting by over 250 per cent while the wholesale price index rose by about 75 per cent during the same period. The year 1990 saw a further spectacular advance in equity prices of being almost doubled up despite a mild setback from the 10th October, 1990. With a sharp fall in global prices, capitalisation of Indian stock markets which peaked at about Rs. 1.09 trillion i.e., $ 60 billion on the 9th October, 1990 is currently around Rs. 900 billion i.e. $ 50 billion as against the current estimated market capitalisation of a little over $ 100 billion of Taiwan and South Korean markets.

The present level of market capitalisation of the Indian stock markets constitutes as much as 20.9 per cent of the gross national product. A statement giving details of market capitalisation since 1950-51 is given in the Annexure III.

On Going Disclosure Requirements

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

Another significant development in the Indian securities market is the emergence of mutual funds. For nearly a quarter of a century since 1964, the Unit Trust of India was the sole mutual fund in the country. A number of mutual funds have been floated during the last three years by Financial Institutions and the nationalised banks, all in the public sector. All these funds, excepting the basic scheme of the Unit Trust of India, are closed-end funds.

In 1989-90, the mutual funds in the country had mobilised about Rs. 60 billion and more or less a similar amount is expected to be raised during the current year. The total investible resources of these mutual funds at the end of September, 1990 was estimated to be of the order of about Rs. 200 billion. The number of investors in these mutual funds has also been growing at a rapid pace, the current figure being placed around 5 million.

Investment Opportunities for Overseas Investors

Investment on Indian stock markets at present is not fully open to foreigners. Foreign investment is subject to well defined and comprehensive provisions embodied in the Foreign Exchange Regulation Act of 1973. Direct foreign investment is as a rule allowed only in collaboration units wherein the foreign collaborator can contribute between 40% and 74% depending upon the status of the industry. Direct investment on stock markets is not allowed to foreigners except the non-resident Indians. Foreigners can, however, subscribe to the extent of 40% in a company owned by the non-resident Indians. Foreigners can also invest through the intermediation of country funds of offshore mutual funds floated for the purpose. Direct foreign investment is also permitted in case of specific funds floated by organisations such as the Asian Development Bank or the Commonwealth Development Corporation.

Non-Resident Indian Investment

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

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

(ii) Portfolio investment in shares and convertible debentures was also liberalised with full benefits of repatriation provided they are purchased through 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 5% of the paid up capital of a company was imposed on total non-resident Indian investments under the portfolio scheme. There are, however, no limits on investment in non-convertible debentures and Master shares of the Unit Trust of India.

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

There are special tax concessions available to investment by non-resident Indians. These include the following:

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

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

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

Even though non-resident Indians have been provided extensive incentives for investment in India their response so far has been modest. As on the 30th November, 1989, total direct investment of non-resident Indians in India was to the tune of Rs. 16.72 billion while under portfolio scheme they had invested Rs. 731.6 million in Indian securities. It is estimated that the total investible funds of non-resident Indians as a
group are in excess of Rs. 1500 billion. Thus their investments in India at present are a little over one per cent of their total investible funds.

In order to mobilize non-resident Indian investment funds in India, several mutual funds have been exclusively floated for mobilisation of these resources. Important among these are India Investment Funds by ANZ Grindllys, Jardine Fleming's JF India Pacific Trust and CIFCO Hill Samuel Unit Trust. Their performance seems to have been modest, but it is hoped that over the years these funds will do better and many more such funds will be floated.

**Offshore Mutual Funds**

While direct foreign investment in India is not permitted except for the investment by non-resident Indians as already indicated earlier and through collaboration managements for others, a via media has been found through floatation of country funds and offshore Mutual Funds. Several countries across the globe have tapped this source very successfully and India joined their rank through the launching of India Fund in London during 1986 by the Unit Trust of India the major mutual fund operator of the country. This fund of the size of $ 110 million was succeeded by another fund, "India Growth Fund" launched by UTI once again, in New York in 1987 which had mobilized U.S. $ 60 million. Last year State Bank of India launched a private placement mutual fund "India Magnum Fund" in Antilles, Netherlands and following overwhelming response the fund was closed at $ 156 million. During the current year Canbank floated the Himalayan Fund for $ 100 million. Several more of such funds are being structured by various operators to cater to different types of investors and will be launched in the days ahead. Agencies like Asian Development Bank and Commonwealth Development Corporation have also shown keen interest in the Indian stock market and a part of the proceeds that these institutions are mobilizing for investment in their constituent countries will be invested in the Indian stock market securities. ADB has already received permission for investment of 20 per cent of its ASEAN Committee securities fund for $ 60 million.

Performance of the three major country funds from India has been heart warming. India Fund and India Growth Fund after an initial lacklustre performance are presently among the best performers within the several country funds. Both of these funds are quoted well above their Net Asset Value (NAV). The latest available figures for the end of September, 1990 show that India Fund with an NAV of 286.70 pence was quoted at 223.5 pence while India Growth Fund with an NAV of $ 18.98 was being quoted at $ 14.25. In October, 1988 India Fund came out with a rights issue and in spite of subdued stock market trends in the international arena, was subscribed to the tune of 66% of the offerings i.e., about $ 69 million, which is considered to be a good performance in the country fund market. The India Magnum Fund also mobilized $ 50 million by way of second tranche. These offshore funds have thus raised $ 557 million so far. The strength of these country funds is all the more remarkable because of the continu-
ous depreciation of Indian rupee vis-a-vis the major currencies of the world including the US dollar and British Pound.

There are still a few hindrances in the way of full growth of the Indian offshore mutual funds, mainly the withholding of 45 per cent tax on long-term capital gains and the depreciating rupee value. It may be observed that several countries in Asia-Korea, Malaysia, Pakistan and Taiwan to name a few do not tax the long-term capital gains. Taxation policies are by nature dynamic and flexible and given the process of liberalisation these anomalies could be corrected with the passage of time. Depreciating rupee is a reflection of structural imbalance in the Indian economy and foreign trade that the country is facing at present but should get corrected in the coming years.

Secondary Market

The turnover in the Indian stock exchanges have zoomed to great heights during the last ten years, particularly during the last three years. On the Bombay Stock Exchange, which accounts for about two-thirds of the business in the country, the daily turnover which was as low as about Rs. 99 million in 1979 shot up to Rs. 1.27 billion in 1989 and further to Rs. 1.73 billion till November in 1990. The virulent boom conditions which dominated the market from June to October, 1990 saw the daily turnover rise further to Rs. 2.52 billion i.e. about $140 million.

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

Trading in Indian stocks is broadly categorised into two groups, viz., specified shares and non-specified securities. Equity shares of dividend paying, growth-oriented companies with a paid-up capital of at least Rs. 50 million with a market capitalisation of at least Rs. 100 million and preferably having more than 20,000 shareholders are normally put in the specified group and the balance in the non-specified group. Stock Exchanges located in Bombay, Calcutta, Delhi and Ahmedabad only 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 80, 58, 40 and 18 companies are classified as specified shares at the Bombay, Calcutta, Delhi and Ahmedabad stock exchanges respectively. With 68 shares being common among them, the number of companies whose equities are traded as specified shares is 128. They account for about 56 per cent of the market capitalisation of the Indian stock markets.
Trading Pattern

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

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

The question of automating trading has been under the active consideration of the Bombay Stock Exchange for quite sometime. It is now almost finally decided to have trading in all the non-specified stocks numbering about 4,100 totally on the computer on a quote-driven basis with the jobbers, both registered and roving, continuously keying in their bids and offers into the computer with the market orders getting automatically executed at the touch and the limit orders getting executed at exactly the rate specified. Hopefully, this will be completed by the end of 1991. The question of extending the facility of screen-based trading to the specified group will be considered thereafter depending upon the success achieved and the experience gained from the system that would be established for the non-specified group. Since the volume of turnover is larger in the specified group, the question of switching over to the order-driven market could also be considered. The Bombay Stock Exchange is thus moving towards a ringless trading system as is the case in most of the developed markets of the world. This would incidentally also facilitate easy handling of the fast growing volume of business in the market.

The above development would also help in injecting transparency into the operations of the Bombay Stock Exchange. This is particularly important for investors who have to be content at present with a bare statement of net to pay in respect of purchases and net to receive with regard to sales, the brokerage amount being added to the former and deducted from the latter, without indicating separately the quantum of brokerage. Yet another major benefit of the change would be generate real time trade information, the volume of turnover being constantly displayed along with the movement of prices indicating thereby the depth of the market at every turn in prices.

PTI Stockscan Service

A landmark in the history of the Indian stock market was crossed in August, 1987 when PTI Stockscan Service was established linking up the Bombay, Calcutta, Delhi, Madras and Ahmedabad Stock Exchanges for the purpose of instant display of prices prevalent at these exchanges as also market related information. The Sensitive Index of the Bombay Stock Exchange related to 30 scrips traded on it and the BSE National Index involving 100 scrips traded on all the five stock exchanges mentioned above are continuously displayed with revisions being made every two minutes. The Stockscan Service, which presently gives, inter-alia, the movement of prices of about 800 shares, is available not only at these five stock exchanges but also at other stock exchange centres. The PTI Stockscan Service has rightly been called the forerunner of the National Market System in the country.

Regulatory Measures

There are no net capital requirements in the Indian stock markets, linking up the volume of business of a firm with its funds as in the developed markets of the world.
Yet a system of checks and balances have been evolved over a period of time which not only tend to control and regulate the volume of business of individual firms but also of the market as a whole. These are mainly confined to specified shares as the speculative pressures are normally concentrated in this group. The principal instruments deployed are discussed below. First, there are the margins. They are of three types, viz., daily margins normally payable in respect of every contract outstanding at the end of the day generally at the rate of 5 to 10 per cent of the contract value which can be hiked to higher levels depending upon the volatility of the market, the higher rates being made applicable to bulls in a rising market and to bears in a falling market. Carry-over margins payable on every contract carried forward from one settlement to another at rates varying from 3 to 15 per cent and ad hoc margins collected from members having unduly large positions. Currently over Rs. 500 millions are being collected by the Bombay Stock Exchange as margin money. Secondly, limits on the movement of prices pegged at 5 to 10 per cent for a day and 10 to 20 per cent for a settlement period of 14 days are imposed. This is kept in abeyance at present as it is felt that a buoyant market should not be fettered by these limits. Thirdly, limits are also imposed on the outstanding business that can be carried forward by a member from one settlement to another and also at any point of time in a settlement. These are currently fixed at Rs. 30 million and Rs. 40 million respectively. Transactions that result in actual delivery are, however, excluded from the latter. Fourthly, limits are also imposed on the extent of jobbing by a member. Fifthly, whenever the outstanding volume of business in any particular scrip exceeds a particular level considered to be dangerous, which normally is five per cent of the outstanding capital of the company, trading in the scrip is permitted only on a spot delivery basis i.e., for delivery and payment on the same day or on the day following the day of the contract. Normal trading is permitted to be resumed only after the outstanding business gets reduced to a reasonable level. Sixthly, on critical occasions, even the outstanding business in a scrip is ordered to be liquidated by certain percentage points, say, by 15 or so, in every settlement. Seventhly, speculative transactions i.e., transactions that do not result in delivery, popularly known as short sales and long purchases, are prohibited. Finally maximum and minimum prices are occasionally fixed for temporary periods.

The above measures are designed not only to keep the speculative excesses under check but also to regulate the movement of prices. As a result, the Indian stock markets have displayed a remarkable degree of poise and stability. The all-India equity Index Number compiled by the Reserve Bank of India fluctuated by an annual average of 25.0 per cent during the decade of 80s as against the corresponding figures of 23.8 per cent and 25.2 per cent at the International Stock Exchange, London and the New York Stock Exchange respectively and an average of 31.2 per cent in respect of 15 leading stock markets of the world.

**Settlement of Transactions**

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

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

The Indian stock markets are also beset with a number of other problems like insider trading, manipulations, take-overs, odd lots defaults, etc., and attempts are being made to solve all these problems.

Insider Trading

Insider trading i.e., trading in securities by persons in possession of material non-public information relating to such securities, which is price-sensitive, still remains uncontrolled. Strangely there is no law as yet prohibiting insider trading in this country. The provisions contained in Section 307 of the Companies Act requiring shareholdings and debenture holdings of directors to be recorded and kept open for inspection of any shareholder of debentureholder during the period of 14 days before and 3 days after the Annual General Meeting of a company has proved to be absolutely ineffectively in controlling such trading. Publication of half-yearly results by listed companies required by the new Clause 41 of the Listing Agreement has also not minimised such trading. It is,
however, expected that the comprehensive legislation relating to the securities industry providing statutory powers to the Securities and Exchange Board of India will embody provisions prohibiting insider trading.

Manipulation

Manipulation of stock prices is quite a common occurrence on Indian stock markets. Strangely, there is not as yet any effective deterrent provision against the same. Expunging manipulated quotations and taking disciplinary action against members of stock exchanges by the stock exchange authorities are the only available measures and even these are rarely resorted to. Drastic penal provisions, including or attempting to indulge in manipulation of stock prices, be they members of stock exchanges or not, on the lines of similar provisions embodied in the statutes of several advanced countries is, therefore, called for to control effectively this growing menace.

Take-Overs

Take-overs which have gripped the western world has now spread to this country too. The only safeguard for the non-management shareholders the country has is by way of a provision in the Listing Agreement incorporated pursuant to a directive issued by Government in April 1984. According to this, any acquisition of shares of a company beyond 25 per cent of the voting capital of the company or securing the effective control of management of the company by acquisition of the shares of the existing directors and others who effectively control or manage the company, irrespective of the percentage of their holdings, should be preceded by an offer to the remaining members of the company to acquire their shares at a price not lower than the price at which the shares of the company are being acquired subject, however, to the public shareholding not being reduced to less than 20 per cent of the voting capital of the company.

The above provision has not proved to be effective due to reasons like acquisition of the shares being limited to 24.9 per cent of the voting capital of the company, change in the management of the company not being clearly discernable as say with only four out of eight directors changing following acquisition of the shares, change in the effective control of management of the company being brought about not by any change in the shareholding pattern of the company but by a change in the pattern of shareholding of the parent company holding shares in the company, acquisition of shares ostensibly taking place at a price much below the ruling market price but in actuality at a much higher price, with the difference being settled privately, etc. The listing provisions were, therefore, amended by government in May, 1990 providing that acquisition of shares beyond 10 per cent of the voting rights in a company should be accompanied by an offer to the remaining members of the company to purchase their shares at a price not lower than either the highest price during the immediately proceeding six months or the negotiated price. The amendment has also provided for notification to the stock exchanges of any acquisition of shares above 5 per cent of the voting capital of the company. The latter provision relating to notification is on par with similar provisions
in U.K. and U.S.A. The level of acquisition of 10 per cent for a mandatory offer is in fact quite low compared to U.K. where the mandatory offer becomes effective only when acquisition reaches the level of 30 per cent of the voting rights of a company. The U.S. laws do not require any mandatory offer to be made to the non-management shareholders. The effect of the new measures is yet to be felt.

Odd Lots

Odd lots constitute a major bugbear for the investors in this country. Out of a total market capitalisation of about Rs. one trillion, equities worth over Rs. 150 billion are in odd lots. Investors normally receive 15 to 20 per cent less than the market price for their sales and have to pay 15 to 20 per cent more than the market price for their purchases of odd lots. Public sector institutions like the New India Assurance Co. Ltd., Canbank Financiál Services Ltd., Unit Trust of India, etc., and also some companies have announced schemes to buy odd lots. The Bombay Stock Exchange and a few other stock exchanges have appointed authorised odd lot dealers with norms for their operations and are also having separate trading sessions for odd lots. All these attempts at a solution to this problem have only touched the fringe of the problem. Permitting companies themselves to purchase the odd lots of their own shares, preferably at the ruling price with the safeguard of approval by the general body to prevent any misuse by the Board of Directors and then to re-issue them, if need be, in market lots on the lines of similar provisions in U.K. and U.S.A. can perhaps provide a lasting solution to this problem. This needs an amendment to the Companies Act, 1956.

Defaults

Under the Rules and Bye-laws of stock exchanges, as they are today, the net assets of a member of a stock exchange who is declared a defaulter are utilised to satisfy first the claims of the exchange and the clearing house run by the exchange and then the admitted claims of the members of the exchange on a pro rata basis. Only if any surplus is left thereafter, the Claims of the clients of the defaulter member are considered by the Defaulter's Committee dealing with the matter and generally there is no surplus left. The clients can, no doubt, go in for arbitration in respect of their claims and obtain awards in their favour and get the same filed in a Court of Law for decree. The decrees, however, do not generally get executed as the defaulter invariably disposes of all his assets before he is declared a defaulter.

Lack of protection to the clients is a serious lacuna in the Indian stock markets. The Ministry of Finance, therefore, directed stock exchanges of the country to set up Customers' Protection Funds. The Bombay Stock Exchange was the first to set up such a Fund. Established in October, 1986, the Fund is patterned on the lines of the Securities Investor Protection Corporation of the U.S.A. Financed partly by way of a levy on the turnover of members collected at the rate of one rupee for every Rs. one million and partly by way of contribution from the listing fees realised at the rate of two per cent of these fees, the Fund has at present over Rs. 3 million after having already distributed
about Rs. 0.35 million to the clients of one of the defaulter members. There is a limit of Rs. 15,000 that may be paid to any single client from this Fund. It is, however, proposed to raise this limit with the inflow of more money into this Fund. The limit for payment to a single customer under the Securities Investor Protection Corporation of the U.S.A. is as high as $500,000, out of which claims for cash as distinct from claims for securities would not be more than $100,000.

**Securities and Exchange Board of India**

A major development in the Indian stock markets which deserves a particular mention is the establishment of the Securities and Exchange Board of India (SEBI), on the lines of the Securities and Investment Board of U.K. SEBI which was established on the 12th April, 1988 will be taking a holistic view of the Indian securities markets. The strident advance in the capital market activities and the growing complexities of the market related problems have necessitated the emergence of this institution. The present regulatory framework segmented in different legislation frameworks like the Companies Act, Capital Issues Control Act, Securities Contracts (Regulation) Act and the various rules, orders, notifications, guidelines etc., issued thereunder will be pieced together into a comprehensive set of legislation covering all aspects of the securities market. Improved disclosure requirements, better accounting standards, greater investor protection cover, simpler arbitration procedures, provisions against insider trading and other malpractices, etc., are expected to be embodied in a statutory framework to be administered by SEBI. This is expected to be operational in the near future.

**Conclusion**

The Indian stock markets, which attained a remarkable degree of growth in the last one decade, are poised for a further leap forward in the current decade. 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. All concerned with the market, the investors, the issuers and the market players and more importantly the regulators - the stock exchange authorities, the Securities and Exchange Board of India and above all the Government of India - have an arduous 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.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>PRIMARY SECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>50.1</td>
<td>41.22</td>
<td>41.16</td>
<td>39.40</td>
<td>40.33</td>
<td>38.95</td>
<td>37.19</td>
<td>35.15</td>
<td>34.02</td>
<td>36.15</td>
</tr>
<tr>
<td>Forestry, Etc.</td>
<td>47.4</td>
<td>36.37</td>
<td>36.45</td>
<td>34.90</td>
<td>36.05</td>
<td>34.69</td>
<td>33.07</td>
<td>31.15</td>
<td>30.45</td>
<td>32.82</td>
</tr>
<tr>
<td>Fishing</td>
<td>1.1</td>
<td>2.78</td>
<td>2.58</td>
<td>2.34</td>
<td>2.00</td>
<td>1.90</td>
<td>1.85</td>
<td>1.61</td>
<td>1.56</td>
<td>1.38</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>0.7</td>
<td>0.72</td>
<td>0.70</td>
<td>0.86</td>
<td>0.76</td>
<td>0.79</td>
<td>0.75</td>
<td>0.77</td>
<td>0.74</td>
<td>0.71</td>
</tr>
<tr>
<td>SECONDARY SECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Manufacturing</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Registered</td>
<td>13.4</td>
<td>16.98</td>
<td>17.32</td>
<td>18.02</td>
<td>18.35</td>
<td>18.87</td>
<td>19.72</td>
<td>20.85</td>
<td>20.64</td>
<td>20.17</td>
</tr>
<tr>
<td>Unregistered</td>
<td>8.3</td>
<td>9.13</td>
<td>9.30</td>
<td>10.05</td>
<td>10.78</td>
<td>11.33</td>
<td>11.98</td>
<td>12.71</td>
<td>12.36</td>
<td>12.16</td>
</tr>
<tr>
<td>6. Electricity, gas &amp; water supply</td>
<td>5.1</td>
<td>7.85</td>
<td>8.02</td>
<td>7.97</td>
<td>7.57</td>
<td>7.35</td>
<td>7.74</td>
<td>8.14</td>
<td>8.28</td>
<td>8.01</td>
</tr>
<tr>
<td>7. Construction</td>
<td>0.9</td>
<td>0.75</td>
<td>0.77</td>
<td>0.76</td>
<td>0.82</td>
<td>0.92</td>
<td>0.96</td>
<td>1.04</td>
<td>1.06</td>
<td>1.04</td>
</tr>
<tr>
<td>TERTIARY SECTOR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Trade, transport and communication</td>
<td>30.2</td>
<td>35.81</td>
<td>35.57</td>
<td>37.05</td>
<td>35.80</td>
<td>36.60</td>
<td>37.48</td>
<td>38.37</td>
<td>39.69</td>
<td>38.31</td>
</tr>
<tr>
<td>10. Community, social &amp; personal Service</td>
<td>9.5</td>
<td>10.97</td>
<td>10.67</td>
<td>11.18</td>
<td>10.66</td>
<td>11.03</td>
<td>11.28</td>
<td>11.67</td>
<td>12.27</td>
<td>11.67</td>
</tr>
<tr>
<td>TOTAL: Net Domestic Product</td>
<td>100.0</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: CSO  
Notes: * Provisional  
+ Quick Estimates
ANNEXURE II

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Preference</th>
<th>Debenture</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>703.8</td>
<td>77.8</td>
<td>93.9</td>
<td>875.5</td>
</tr>
<tr>
<td>1965</td>
<td>680.6</td>
<td>105.5</td>
<td>216.2</td>
<td>1,002.3</td>
</tr>
<tr>
<td>1970</td>
<td>637.1</td>
<td>110.8</td>
<td>119.2</td>
<td>867.1</td>
</tr>
<tr>
<td>1975</td>
<td>634.3</td>
<td>48.6</td>
<td>301.5</td>
<td>984.4</td>
</tr>
<tr>
<td>1981-82</td>
<td>2,430.6</td>
<td>26.5</td>
<td>3,156.0</td>
<td>5,613.1</td>
</tr>
<tr>
<td>1985-86</td>
<td>8,350.5</td>
<td>10.1</td>
<td>7,981.8</td>
<td>16,342.4</td>
</tr>
<tr>
<td>1986-87</td>
<td>10,294.7</td>
<td>--</td>
<td>17,407.0</td>
<td>27,701.7</td>
</tr>
<tr>
<td>1987-88</td>
<td>8,099.9</td>
<td>--</td>
<td>6,642.0</td>
<td>14,741.9</td>
</tr>
<tr>
<td>1988-89</td>
<td>11,500.0</td>
<td>--</td>
<td>24,000.0</td>
<td>35,500.0</td>
</tr>
<tr>
<td>1989-90</td>
<td>12,450.0</td>
<td>50.0</td>
<td>49,000.0</td>
<td>61,500.0</td>
</tr>
<tr>
<td>Year</td>
<td>G.N.P. at current prices</td>
<td>Annual rate of growth</td>
<td>As on 31st December</td>
<td>Market Value of listed equity capital</td>
</tr>
<tr>
<td>----------</td>
<td>--------------------------</td>
<td>-----------------------</td>
<td>---------------------</td>
<td>--------------------------------------</td>
</tr>
<tr>
<td>1950-51</td>
<td>91.36</td>
<td>5.3</td>
<td>1950</td>
<td>6.35+</td>
</tr>
<tr>
<td>1960-61</td>
<td>139.99</td>
<td>7.2</td>
<td>1960</td>
<td>10.47+</td>
</tr>
<tr>
<td>1970-71</td>
<td>364.52</td>
<td>8.7</td>
<td>1970</td>
<td>23.29</td>
</tr>
<tr>
<td>1975-76</td>
<td>663.75</td>
<td>5.3</td>
<td>1975</td>
<td>28.05</td>
</tr>
<tr>
<td>1980-81</td>
<td>1138.46</td>
<td>19.2</td>
<td>1980</td>
<td>58.43</td>
</tr>
<tr>
<td>1985-86</td>
<td>2135.53</td>
<td>12.7</td>
<td>1985</td>
<td>207.83</td>
</tr>
<tr>
<td>1986-87</td>
<td>2588.75</td>
<td>21.2</td>
<td>1986</td>
<td>221.59</td>
</tr>
<tr>
<td>1987-88</td>
<td>2915.01</td>
<td>12.6</td>
<td>1987</td>
<td>265.11</td>
</tr>
<tr>
<td>1988-89</td>
<td>3469.45</td>
<td>19.0</td>
<td>1988</td>
<td>391.33</td>
</tr>
<tr>
<td>1989-90</td>
<td>4300.00$</td>
<td>23.0</td>
<td>1990*</td>
<td>554.09</td>
</tr>
<tr>
<td>23.11.90</td>
<td>4300.00$</td>
<td>23.11.90</td>
<td>900.00$</td>
<td></td>
</tr>
</tbody>
</table>

+ Estimated  $ Provisional  *As on 31st March
MEETING OF FIBV
SUGGESTIONS REGARDING POSSIBLE AREAS OF
ASSISTANCE BY FIBV TO EMERGING MARKETS

by

M. R. Mayya
Executive Director
The Stock Exchange, Bombay

The emerging or the newly established stock exchanges are often forced to grope in
the dark mainly due to lack of guidance and assistance. In the process, they are prone to
commit mistakes which can easily otherwise be avoided. Guidance and assistance of
different types are, therefore, required if the growth of these markets have to be on healthy
and orderly lines. Federation Internationale Des Bourses De Valeurs (FIBV) can play an
important role in strengthening the emerging stock markets through technical, educational
and financial assistance. The major areas in which such assistance can be provided are
enumerated below:

Technical Assistance

Emerging stock exchanges often face the problem of lack of expertise during the
initial phase, especially, if the country concerned does not have the stock exchange culture.
FIBV can help such stock exchanges by making available services of experts for this
purpose. FIBV can create a centralised pool of experts whose services can be availed of by
the emerging markets during their early days so as to enable them to develop a proper
infrastructure and administrative machinery.

Emerging markets often find it difficult to develop a comprehensive market regula-
tory system, especially if the country concerned does not have an otherwise well developed
financial institutional structure. FIBV can help them to evolve such a system. FIBV can
develop a model set of comprehensive legal and regulatory structure for the governance of
the stock markets. Individual stock exchanges may then adopt the same with due
modifications as required by the local conditions, traditions and other supporting institu-
tions prevailing in the country concerned. FIBV can also undertake a review of the legal and
regulatory framework governing stock exchanges in a particular country on specific
request from the stock exchanges and suggest necessary reforms to strengthen the stock
exchange activity.

Several emerging stock markets lack necessary expertise to evaluate the EDP
systems that will serve their needs. The problem has become more acute because of the fast
pace of developments in the computer and electronics industry. As a result, there is a likely
danger that these stock exchanges may be saddled with inadequate or improper systems unless knowledgeable expert support becomes available for them to assess their needs, identify the hardware and software that will produce the desired results and tone up the operational efficiency of the stock exchanges concerned. It is, therefore, recommended that FIBV may provide technical assistance to the emerging markets to assess their technological needs to select and install the necessary hardware and to develop the software and to train the stock exchange personnel to effectively handle the system.

Educational Assistance

It is necessary that the stock exchange administrators possess the necessary professional skills and exposure to the recent developments in the stock markets across the world. A suitable training programme needs to be evolved not only for the senior and middle level administrators of the emerging stock markets but also for selected stockbrokers. It is, therefore, suggested that FIBV may consider the desirability of establishing a centralised training institute to offer training programmes for these persons. This can be supplemented by desk experience in markets of developed countries. FIBV can also assist the stock exchanges and other stock exchange related institutions to develop their own training organisations to cater to the local needs.

It is further recommended that FIBV may periodically arrange seminars and workshops, at both regional and global levels, in different parts of the world so that new concepts and ideas that originate, are disseminated in all these countries.

There is a lot of hesitancy on the part of emerging markets to open up their markets basically due to fears that the foreigners will swamp the markets to the detriment of locals and to the country. A detailed analysis of all these fears with possible checks to take care of any attempts, overt or otherwise, to destabilise these markets, needs to be made. Experiences of various other countries have to be studied and drawn upon to minimise such apprehensions. The utility of opening up the markets not only from the point of rendering the markets more efficient but also of acting as another source of foreign exchange needs also to be highlighted.

FIBV may also establish a centralised data pool and information services especially information on listing, trading and settlement systems. There may also be a corporate database profiling salient features of companies likely to open to foreign participation. Such a centralised information service should process, publish and widely circulate the developments in the stock markets across the world to enrich the users of these services. There may be a Fact Book released every year highlighting achievements made, with problems and prospects facing these markets also mentioned.

Financial Assistance

Many emerging markets suffer from resource crunch, more so during the initial days when listings are few and turnover low, to enable them to create a viable infrastructure such
as proper building and hardware. Inadequacy of infrastructure impairs healthy development of the stock exchanges. It is pertinent to observe in this connection that Governments in quite a few of these countries consider stock exchanges as citadels of capitalism which they feel should not be funded by them. The problem becomes more serious in the case of exchanges in such countries which do not have adequately developed computer industry and which suffer from the foreign exchange scarcity to take up developmental or upgradation activities through their internal resource mobilisation. It is, therefore, recommended that FIBV sets up an Emerging Markets Assistance Fund by taking assistance, if need be, from the World Bank and regional institutions like the Asian Development Fund. Necessary financial assistance by way of grants and loans at concessional rates may be made available from this Fund to the needy stock exchanges to develop or upgrade their infrastructure.

INDIAN STOCK EXCHANGES:
RESPONSIBILITIES AND AUTHORITY®

By
M.R. Mayya,
Executive Director,
The Stock Exchange, Bombay.

India has a long tradition of trading in securities dating back nearly two hundred years. In fact, the first Indian Stock Exchange established at Bombay in 1875 is the oldest Exchange in Asia. Ever since the Indian stock market system has evolved over the years backed by a well-developed legal system and an evolutionary regulatory framework. While the pace of growth of the stock market was comparatively pedantic till the advent of decade of eighties, there was a capital market revolution in the country during the eighties underlined by the phenomenal growth and expansion of the market which is probably unparalleled in the global context. The growth was mainly propelled by the gradual liberalisation of economic and industrial policies by the Government and a deliberate shift from command economy. This shift in emphasis brought the stock exchanges in limelight as major vehicles of economic growth and naturally their functioning, responsibilities that they owe and the authorities they enjoy have become a subject of lively debate.

Responsibilities and authorities of the stock exchange and for that matter of any institution are influenced by the environment within which they operate. For example, in 1875, the main objective for the promotion of the Stock Exchange, Bombay was to protect the character, status and interests of the native share and stockbrokers. In 1992, the Stock Exchanges have a much wider role to play wherein protection of the investors’ interests becomes the paramount concern. Therefore, to understand the prevailing scenario in proper perspective it is necessary to examine and assess the various influencing factors which condition the activities of the Stock Exchange.

Growth of the Market

The phenomenal and unprecedented growth of the stock market ever since the decade of eighties is one of the important influencing factors. The growth syndrome can be explained by using various parameters. The number of Stock Exchanges in the country have increased from 8 in 1980 to 21 in 1992. Capital raised from the primary market, which averaged around Rs. 900 million per annum during the seventies, amounted to Rs. 57.49 billion during 1991-92 and during the current year is expected to cross Rs. 150 billion mark amounting to about 11 per cent of the gross domestic savings. More importantly, similar matching large amounts are also being mobilised by mutual funds which are ultimately invested in the stock market securities. The number of listed companies has almost tripled

© Text of Address delivered at Conference on Securities Clearing and Settlement in India organised by Financial and Business Media Associates Ltd. at The Oberoi Hotel, Bombay on the 29th-30th October, 1992.
over the decade from 2,200 to 6,500 and as a result, this country now has the distinction of having the second largest number of listed companies, next only to the United States of America, which had 6,742 listed companies at the end of 1991. The number of shareholders have risen sharply from about 2 million at the end of seventies to over 15 million at present and if we include the investors in convertible debentures and mutual funds, the number may be about 25 million investors. Market capitalisation which was Rs. 58.43 billion accounting for only about 5 per cent of G.N.P. a decade ago is now about Rs. 2.5 trillion amounting to about 40 per cent of G.N.P., which is comparable with that in some of the developed countries. In the secondary market, the average daily turnover on the Bombay Stock Exchange, which accounts for nearly 2/3rds of the trading volume in the country, has increased from Rs. 95.7 million in 1979-80 to Rs. 3.34 billion in 1991-92. In fact, with about 90,000 deals executed in a two hour trading session, BSE has the highest per hour trading intensity in the world next only to the Taiwan Stock Exchange.

Impressive as the growth so far has been, more enchanting are the prospects of a further quantum jump in the growth expected during the next few years. Deregulation and liberalisation of economic policies are expected to be extended further and in the changed circumstances the stock market will provide the major portion of financial resources to the corporate sector. Planning Commission expects that more than Rs. 250 billion a year will be mobilised on the stock markets by the terminal year of the Eighth Plan of the country and if the current scenario is any indicator, the target may be exceeded even earlier. Disinvestment of public sector shares or privatisation of public sector undertakings to use the more accepted nomenclature is another dimension of the growth syndrome. Already shares worth Rs. 30.36 billion were disinvested in 1991-92 and shares worth another Rs. 35.0 billion are expected to be disinvested in the current year. Not only would there be further disinvestment by the Government, these undertakings would also rely extensively on the stock market for their future resource requirements. Similarly, development financial institutions, which hitherto had access to Government funds, will now be relying more on the market to raise the necessary funds. Permission for reputable foreign funds to invest in Indian markets, to the extent of 24 per cent, guidelines for which have been recently issued, is only the preliminary step before the markets are fully opened to the foreign investors. At the same time, Indian companies are to raise funds on international markets through Global Depository Issues. As a logical extension, in future, foreign companies may be allowed to be listed on the Indian stock exchanges and raise resources on Indian markets. All these developments will have undoubtedly a tremendous impact not only in terms of quantitative growth but also in a qualitative change in the Indian stock market system in a medium-term period. The system and its operations have, therefore, to be assessed in this environment.

Regulation of Stock Exchanges

The stock exchanges as a result, therefore, need to function to meet varied objectives. They have to provide a well-developed, efficiently administered and properly regulated market system which facilitates efficient mobilisation and allocation of resources for the corporate sector and liquidity to the investment of investors by providing a fair and orderly market. The stock exchanges no more exist only to protect the interests of the stockbrokers but play a more wider public role where they have responsibility towards the investors, the
corporate sector, the Government and the society at large. It is, therefore, necessary to analyse the prevailing situations in the primary and the secondary markets so as to understand the responsibilities of the stock exchanges to improve the performance of different segments of the market.

Primary Market

An efficient primary market which brings together the user and the investor of funds directly provides the most effective and the cost-efficient source for mobilisation of financial resources. Moreover, viability of a project is not decided by an individual but by the market through its response to the issue. In India, till recently the office of the Controller of Capital Issues not only used to approve of any issue of capital but also the price at which such an issue was to be offered to the investors. This was with avowed intention to avoid investors to be taken for a ride by smart operators. Following the abolition of Capital Issues (Control) Act, 1947 in May, 1992, issuers are free to offer their issues at a price to be fixed by them in tune with the guidelines issued by the Securities and Exchange Board of India (SEBI) for the purpose. These guidelines allow almost all issuers except the new entrepreneurs without any track record to issue their securities at premium. This has enthused the corporate sector leading to a spate of public and rights issues in recent months.

The efficient performance of the primary market in this country is handicapped by several procedural and other problems. First, the issue applications have to be collected at 57 mandatory centres spread throughout the length and breadth of the country for a minimum period of three days. Till recently, with regulated pricing, most of the issues were being offered at a heavy discount to their market value and with the immediate prospects of appreciation, there was heavy oversubscription. Banking and postal systems prevailing in the country are not fully geared to cater to the increased workload in the primary market. The expected avalanche of issues in the coming months is going to further aggravate the situation. It is, therefore, necessary to revise the whole issue procedure so that investors are not adversely affected by the excessive time taken in allotment. In fact, quicker allotments and refunds will ensure greater resource mobilisation in the primary market with the investors' funds being released quickly.

Schedule II of the Companies Act as amended in October, 1991, also provides for detailed disclosure of information in prospectus to an issue including management's perception of the risk factor. Similarly, SEBI guidelines on new issues also have provisions to ensure availability of full and fair information to the investors to base their investment decision. These guidelines also provide that merchant bankers authorised by SEBI shall exercise due diligence independently verifying the contents of the prospectus and reasonableness of the views expressed therein. The merchant bankers shall certify to this effect to SEBI. Nonetheless, a proper check on these disclosures is called for which stock exchanges and SEBI are expected to exercise.

All issuers, except brand new companies promoted by new entrepreneurs without any track record, are now given the freedom to price their issues subject to the requirement of disclosure about the net asset value and a justification for the price of the issue. This has no doubt bridged to a great extent the earlier wide gap between what the market can bear.
and what the issuer could get with all problems attendant on heavy subscription. Apprehensions are, however, expressed in some quarters about the likely misuse of this freedom by unscrupulous operators. The likely statutory sanctions against insider trading and manipulation of prices expected shortly with strict enforcement of these sanctions are expected to act as effective checks against such misuses.

Another fundamental issue that needs to be examined is the present day practice of listing companies without any previous track record. This was perhaps necessary when the market was not fully developed and there was a lack of alternate modes of finance. With bought out deals of brand new companies by financial institutions and mutual funds who nourish them till they attain the break-even point, if not the dividend-paying stage, venture capital funds who finance high-tech green field companies of first generation entrepreneurs and the OTC Exchange of India which takes care of the listing requirements of smaller companies, the time has now come to prescribe a minimum track record for listing of companies on the stock exchanges. This will ensure that the companies have certain minimum standards necessary to enable establishment of an active secondary market in their securities.

The present time-frame prescribed under Section 73 of the Companies Act for completing allotment of securities and dispatch of allotment letters/share certificates and refund orders is 70 days. This leads to locking-up of investors' funds for a considerable period of time. While the recently introduced instrument "stock invest" addresses the issue as investors' funds are not released till allotment, there is an equally urgent need to examine the possibilities of reducing this time-frame so that secondary market trading starts at an early date. The question of permitting trading on the lines of delivery "as and when issued" in vogue in some of the advanced markets needs consideration.

Secondary Market

Stocks for trading on the stock exchanges are broadly classified into two groups, viz., specified shares and non-specified securities. All listed securities are initially classified as non-specified securities and shift to the group of specified shares is generally based on the following criteria.

(i) The company should have been listed for at least 3 years.
(ii) The company should have an issued capital of Rs. 75 million with a market value of 2-3 times thereof. Besides the publicly held shares should be at least Rs. 45 million of face value.
(iii) There should be a minimum of 10,000 public shareholders.
(iv) The company should be growth-oriented and on dividend-paying list.
(v) Shares of the company should have been actively traded in the preceding 6 months.

All trading is basically on a hand delivery basis i.e., for settlement 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 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.

While trading in specified shares has to a large extent met the requirements of the market till recently, it is necessary to segregate cash trading from derivative trading. Derivatives trading through futures and options perform the essential function of providing hedging facility against the risk factors. So far, futures and options trading is banned in India. It is our intention to start futures and options in the near future with all the necessary checks and balances to avoid abuse of the system. The present pattern of trading in specified shares will then automatically wither away.

Indian stock markets continue to operate in the age-old conventional style of face-to-face trading with bids and offer being made by open outcry. The stock exchanges 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 0.1 to 0.25 per cent as compared to 1.5 to 2.0 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 in several of the sporadically traded stocks, 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 over 75 per cent of trading in the Indian stock markets. This is mainly because the jobbers at present do not get any facilities like reserved allotments in new issues or financial assistance in liberal terms. It is significant to note that about 1,600 securities get traded on any given trading day on the Bombay Stock Exchange.

Settlement of Transactions

Settlement processes at the Indian stock markets are progressively getting streamlined. At the Bombay Stock Exchange, settlement of transactions by way of delivery of securities and payment of price takes about 10 days to 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. We have now launched on a Rs. 750 million worth programme of modernisation and computerisation split into four phases. The first phase providing for
display of information in the Trading Ring and offices of members of the stock exchange
bid, offer and transaction prices of about 750 actively traded scrips, company and stock
exchange announcements, news from PTI, etc., through the Display Information Driven
System (DIDS) based on SUN Sparc 4/470 Server and 50 Sparc Station - 1s, will be operative
shortly from day one of our entry into the new state-of-the-art trading ring.

The second phase to be operational from March, 1993 would convert the input and
output interfaces from the present manual mode to a completely electronic one. Reporting
of daily transactions, the first phase of corrections for unmatched transactions and
transmission of reports generated by the settlement system would be carried out directly
from the offices of members, eliminating the duplication of input/output by the Exchange
which causes delay.

The third phase would provide for automation in the trading system, so as to add
functionality in automation in manageable steps, and trading in all the non-specified stocks
totally on the computer would initially be done taking care, however, to retain the basic
characteristics of the market such as the system of jobbing. Order execution would be,
totally screen-based for this group. It is expected to initiate this phase immediately after the
members move over to their permanent offices within the Exchange complex which process
would be completed by December, 1992. Software for the third phase is being developed
by CMC. Trial runs for Phase III are expected to commence in Quarter III of 1993 and the
system is expected to go "live" in the last quarter of 1993.

Phase IV: In the fourth phase, the facility of screen-based trading would be
extended to the specified shares from the beginning of 1994.

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

All the above measures are designed basically towards improving liquidity in the
market by reducing the settlement cycle. We will, however, not wait for automation and
immobilisation programmes for switching to a weekly trading cycle, Monday to Friday, to
be settled in the following week in respect of non-specified securities. We will start them
soon after we move on to the new trading ring. Once our automation and immobilisation
programmes become operative, we will switch 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.

Share certificates and dated transfer deeds constitute a major hurdle in the growth
of the securities business. A two-stage solution to the problem is, therefore, planned. First,
the problem of immobilisation of securities is to be dealt with. A beginning has already
been made with the establishment of the Stock Holding Corporation of India which handles
the shares of financial institutions. In addition, the Bombay Stock Exchange has, in asso-
cation 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 involved in carry-forward transactions worth about Rs.500 crores 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. The second stage is to develop a certificateless society as has already been done in Norway, Denmark and France and as is being planned in U.K. by the proposal to establish TAURUS. In fact, a proposal in this behalf was put forward by the Bombay Stock Exchange way back in 1979. Serious attempts are now being made to put this proposal into operation. However, for share depositories to start functioning a legislative enactment from the parliament is necessary. The said legislation is expected to be introduced by the Government in near future. Since the depositories start functioning, book-entry transfers will be possible.

Regulation of the Market

The stock exchanges at present have a multitude of weapons to ensure the establishment of a fair and orderly market free from destabilizing impacts of volatile price fluctuations. The Stock Exchanges employ these regulatory tools as and when the situation so warrants. It can be said that during the volatile secondary market of 1990-92, it was because of the effective use of these measures that the market did not face any major crisis even though there were wide swings in prices during this period. The measures used for the purpose include the following:

(i) Collection of daily margins normally varying from 15 per cent to 50 per cent of the contract value to act as a price protective measure against likely adverse movement, in prices in a settlement period and as a price corrective measure when higher rates of margins are made applicable to purchases in a rising market and to sellers in a falling market.

(ii) Imposition of carry-over margins normally varying from 10 per cent to 25 per cent payable in respect of the carry-forward position from one settlement period of 14 days to another in respect of specified shares.

(iii) Ad-hoc margins collected from those members having relatively large positions or those members otherwise considered to be vulnerable.

(iv) Limits on jobbing.

(v) Limits on carry-forward position from one settlement to another by a member in respect of individual scrips, aggregate purchases or sales and aggregate purchases and sales put together.

(vi) Limits on outstanding position in the market as a whole. Normally whenever outstanding position in a scrip exceeds say 5 per cent of the issued capital of the company, trading in the scrip is shifted to spot delivery and brought back.
to forward only after the outstanding position in the scrip gets reduced to say 2.5 per cent of the issued capital of the company.

(vii) Ban on speculative purchases (i.e., long purchases) and speculative sales (i.e., short sales).

(viii) Compulsory requirement to reduce the outstanding carry-forward purchase position in a rising market and the outstanding carry-forward sale position in a declining market.

(ix) Limits on purchases for delivery in a rising market and on sales for delivery in a falling market.

(x) Limits on the fluctuations in prices in a day and in a settlement period.

(xi) Maximum prices in a period of boom and minimum prices in a period of depression.

The various corrective measures mentioned above deployed by the stock exchange authorities have ensured the relative stability of the market. 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 of 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 (till September) have, however, proved to be years of greater volatility. The RBI index fluctuated in these three years by 56.2 per cent, 55.9 per cent and 67.1 per cent respectively basically because of larger speculative activities and the sharp advances in prices reflective of the era of liberalisation and deregulation of the economy.

The financial institutions and mutual funds need to play a positive role in this regard and sell in a rising market and buy in a falling market which would incidentally be to their own advantage, and not take an insular stand as advocated by a section in the market. Stabilisation is a global goal today and we can ill afford to be by-standers.

Investor Protection

A major objective of regulation of stock exchanges is to protect the investors. The Financial Services Act, 1986 of U.K. accorded the highest priority to investor protection. In fact, for an orderly and healthy growth of the capital market investor protection is an essential prerequisite.

Investors need protection not only from the stock brokers but also from the companies. In fact, the protection of investors from acts of omission and commission from companies which account for the major percentage of problems of the investors have not received the attention they deserve. The Companies Act, 1956 and the Listing Agreement
that the companies enter into with the Stock Exchange provide for number of safeguards for the purpose. Some of the important problems faced by the investors while dealing with the companies include:

(i) **Delayed Refund of Application Money.**
The Companies Act provides for a period of 70 days from the closure of the issue and provision to pay interest on delayed period at 15% per annum. However, often companies resort to backdating the refund orders and thereby denying the investors the interest due. The new financial instrument "Stock Invest" wherein funds remain credited to the investor's account and are released in favour of the company only in case of successful applications, should solve the problem to a considerable extent. The stock exchanges, at the instance of SEBI, have recently introduced a scheme of collecting one per cent of the issue amount as deposit which is to be forfeited if the company fails to comply with the listing requirements and the other requirements of law in time or to attend to investors' complaints.

(ii) **Delays in Transfer**
The other major problem faced by the investors is with regard to delays in share transfers. While the Listing Agreement provides for a period of one month and the Companies Act and the Securities Contract (Regulation) Act, provide for a period of two months, companies often take more time for the purpose. Even though at times there may be genuine and unavoidable reasons for the purpose, the practice is not pardonable. The action taken by the Bombay Stock Exchange by way of suspension of dealings in the securities of some companies has acted as a check on such practices. It is heartening to note that the Company Law Board has recently initiated action against many prominent companies in this regard. It is hoped that all these would produce the desired results of instilling greater discipline in companies.

(iii) **Proliferation of Odd Lots**
Odd lots, i.e., holdings in other than market lots, of securities arising out of rights/bonus issues in non-marketable lots, is another major problem faced by the investors. While companies are persuaded to issue securities in marketable lots only, the only lasting solution appears to be to permit companies to buy their shares for consolidation into market-lots for re-issue in market lots, if need be. This will require an amendment to Section 77 of the Companies Act.

(iv) **Protection Against Take-overs**
The Listing Agreement provides that whenever any person acquires 10 per cent or more of the voting rights in a company or secures the control of management of a company by acquiring, irrespective of the percentage of the voting capital, the securities of the directors or other members who control or manage the company, an offer has to be made to the non-management shareholders to the extent of 20 per cent of the holdings of the company at a price not lower than either the average of the highest weekly prices during the
immediately preceding 26 weeks or the negotiated price, whichever is higher. This has been in operation for about two years. As the remedial measures against defaults in such cases can at best be delisting of the securities of the company, there needs to be a statutory code with stronger sanctions against defaulters. SEBI is expected to come out with such a code in the near future.

(v) Management of Companies

Equity capital is no doubt based on the risk-reward theory. While sickness due to unavoidable and unforeseen factors like changes in policy, power cuts, labour problems, alterations in the demand pattern for goods, technological advances, etc., is understandable, although not desirable, sickness due to mismanagement of companies erodes seriously investor confidence. Stringent action against the concerned persons is, therefore, called for.

Investor Protection Against Stockbrokers

Investors need protection from stock brokers on several counts. These include:

(i) non-payment or delay in payment of shares sold,
(ii) non-delivery or delay in delivery of shares purchased,
(iii) lack of cooperation to rectify defective deliveries, and,
(iv) excessive jobbers' spreads, etc.

The stock exchanges have, under the Rules, Bye-laws and Regulations, sufficient and stringent powers to take remedial action against erring stockbrokers and action is being taken in this behalf as and when such complaints are received. However, the major problems arise because most of the investors trade through the intermediation of sub-brokers who hitherto were totally unregulated. It is hoped that following registration of sub-brokers by SEBI, this problem may be solved to a great extent.

Welcome as the process of registration of sub-brokers is, the question of ensuring that the class of sub-brokers withers away completely, lock, stock and barrel, in the next few years, needs serious consideration. This problem is something peculiar to India. Stockbrokers of the country must have a nation-wide network of their offices spread over each and every nook of the country like the network of the banking industry or the postal department and investors should have only brokers' contracts with them which are easily enforceable and not be littered with memos or contracts of sub-brokers, enforcement of which is a well-nigh impossible proposition, at any rate for small investors.

The positive side of investors protection is to educate the investors about the market practices, their rights and obligations. The Bombay Stock Exchange on its part has started an Investors' Education Programme under aegis of its Training Institute. This gives comprehensive information to the investors about the whole spectrum of stock market operations. The Training Institute also conducts seminars, workshops and short duration courses at various places in the country.
The presidents of stock exchanges in their Calcutta meeting held on the 5th September, 1992, had decided to launch a widespread publicity campaign to educate the investors and to improve the image and creditability of stock exchanges in the minds of public at large. Spade work in this behalf has already been done and a publicity blitz is expected soon.

The third angle to investor protection is to indemnify the investors of a defaulting broker. The Bombay Stock Exchange established a Customers' Protection Fund in 1986 to protect the investors whenever a broker defaults. This fund at present indemnifies investors up to a maximum of Rs.25,000 against their genuine investment claims i.e., where shares have been delivered but payments have not been received or payments for shares purchased have been made but shares not received. It is the intention of the exchange to progressively increase the indemnity amount so that ultimately, there is hundred per cent insurance to the investors in this regard.

Authority of Stock Exchanges

Indian stock exchanges are among the most comprehensively regulated exchanges in the world. The regulatory framework which has been evolving ever since the passage of the Bombay Securities Contracts (Regulation) Act of 1925 of the erstwhile State of Bombay and later of the Securities Contracts (Regulation) Act of 1956 of the Union of India aims at providing market forces to operate in a free and well regulated environment. The emphasis of the regulatory model pursued in India is on the development of the self-regulatory organisations which are allowed to exercise their control on their internal operations and activities of their members subject to the overall powers of the external regulatory agencies to supervise and direct their operations. Regulation of the Stock Exchanges which are the oldest and the most comprehensively regulated self-regulatory organisation is carried out through a three-tier regulatory structure comprising the Ministry of Finance (MOF), the Securities and Exchange Board of India (SEBI) and the Governing Board of the Stock Exchanges according to the overall legal framework provided by the Securities Contract (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992. The Stock Exchanges, through their own Rules, Bye-laws and Regulations, which have to be approved by the Government of India or the SEBI, codify the framework for the internal regulation and governance of the Stock Exchanges. The powers and the responsibilities entrusted to the different tiers of the regulatory system are described below.

Ministry of Finance

The Ministry of Finance (MOF) through the Stock Exchange Division administers the Securities Contract (Regulation) Act, 1956 under the SC (R) Act and the SC (R) Rules. These include the following:

i) Application of the provisions of the SC (R) Act to any state or area of the country having regard to the nature of the volume of transaction in securities in that state or area, and licensing of dealers in other areas.

(ii) Granting of recognition to the stock exchanges and withdrawal of recognition already granted.
(iii) Calling for periodic and annual returns from the stock exchanges.

(iv) Inspection of books of accounts and other documents of the stock exchanges and of their members and ordering audit of the accounts of the members of the stock exchanges.

(v) Ordering an enquiry into affairs of the stock exchanges and of their members and directing the stock exchanges to take disciplinary action against the offending members.

(vi) Approval to the Rules, Bye-laws and Regulations of the stock exchanges and amendments thereto and also power to make or amend the Rules, Bye-laws and Regulations.

(vii) Supersession of the Governing Boards of the stock exchanges.

(viii) Suspension of trading in times of emergencies.

(ix) Compelling public limited companies to get their securities listed on the stock exchanges and acting as appellate authority for companies if their listing applications have been rejected or they have been delisted or trading in their securities has been suspended by the stock exchanges.

(x) Permitting companies to offer to the public less than the prescribed percentage of its capital for listing on the stock exchanges.

Under the SEBI Act, the Ministry of Finance has power to appoint the chairman and members on SEBI Board, supersession of the SEBI Board, issue policy directives to SEBI and the appellate and supervisory powers over the Securities and Exchange Board of India.

The Rules, Bye-laws and Regulations of the stock exchanges vest in the Ministry of Finance powers to nominate the presidents and vice-presidents of the stock exchanges and to approve the appointment of executive chiefs and nominations of the public representatives on the Governing Boards of stock exchanges.

The Securities and Exchange Board of India

The growth of the Indian stock market, especially during the decade of eighties, necessitated creation of an independent regulatory agency. The Securities and Exchange Board of India established in 1988 through a Government notification was given the statutory powers on the 31st January, 1992 through an ordinance and the SEBI Act was later passed by the Parliament and assented to by the President on the 4th April, 1992.

SEBI has been given wide ranging powers under the Act to regulate Stock Exchanges, other securities market, market intermediaries, mutual funds and the self-regulatory organisations of the market players. SEBI is also to provide protection to investors from insider dealings and from manipulative and fraudulent trade practices. The
positive role assigned to SEBI relates to the development of the market and promoting investors' education.

SEBI has also been given various powers under the SC (R) Act. SEBI has now been entrusted with the power to call for periodical returns from stock exchanges, to hold inquiries into the affairs of stock exchanges or of its members, to approve amendments to the Bye-laws of stock exchanges, to make Bye-laws of stock exchanges, to license dealers, and to compel companies to list their securities on stock exchanges which were hitherto exercised by the Government of India. Government of India has also delegated to SEBI powers to approve amendments to the Rules of the stock exchanges, make Rules of stock exchanges, call for annual reports, suspend dealings in stock exchanges, supersede the governing boards of stock exchanges and prohibit certain types of contracts.

The role of SEBI, as succinctly put by the Narsimham Committee, should be that of a market regulator to see that the market is operated on the basis of well laid-down principles and day-to-day operations can best be managed by the self-regulatory organisations such as the Stock Exchanges, who have the necessary competence and machinery to perform the job. The role of SEBI should generally be confined to off-site supervision to ensure compliance with its guidelines with on-site inspections being resorted to only where necessary.

The Stock Exchanges:

The governing board of the stock exchange consisting of elected member-directors, Government nominees, public representatives and the executive director has substantial powers vested in it under the Rules, By-laws and Regulations of stock exchanges. These powers include overall control on the members including their admissions, registration and expulsion, adjudication of disputes, imposition of penalties and regulation of the market.

The executive director enjoys wide ranging powers conducive for efficient and smooth day-to-day functioning of the Stock Exchange.

The stock exchanges to succeed in discharging their duties competently need sufficient authority to take action against the listed companies and the stockbrokers. The authorities enjoyed by the stock exchange vis-a-vis listed companies and the stockbrokers are discussed below.

Authority of Stock Exchanges:

Against Companies:

The listing agreement that the companies enter into with the stock exchange imposes several initial and on-going listing requirements for the companies encompassing wide ranging areas such as disclosure of information, facilitating transfers, consolidation and splitting of share certificates, protection to shareholders at the time of take-overs, etc. However, the stock exchanges have not been given any powers to take any action except suspension of admission to dealings or delisting of securities. Suspension and delisting
though stringent in nature harm investors more than the companies and, therefore, do not prove to be effective. The Bombay Stock Exchange has suspended dealings in over 700 companies for varying periods during the last three years for various offences like delay in return of share certificates and refund orders, failure to publish half-yearly results, etc. These preventive measures have had some salutory effect on companies but have not proved to be deterrent enough against the habitual offenders. More effective punitive provisions are needed to discipline companies.

One such provision can be to disqualify the directors as provided under the Disqualification of Directors Act of 1986 of the United Kingdom. This will make the directors more vigilant to ensure enforcement of the listing agreement. Similarly, the stock exchanges should have powers to impose fines and institute civil and criminal proceedings against “officers in default” of companies.

Against Stockbrokers

The stock exchanges have extensive powers against stockbrokers under its Rules, Bye-laws and Regulations for contravention of the provisions thereunder. The violations which are indulged in by the members include evasion of payment of margins, breaching the various trading restrictions such as limits on carry-forward and jobbing, prohibition of further dealings except for delivery, compulsory liquidation of outstanding business, etc., kerb trading, failure to attend to investors’ complaints, etc. These powers of the stock exchange range from censure, reprimand, warning, fines, suspension or withdrawal of all or any of the membership rights, to expulsion. The governing board, the disciplinary action committee and the executive director take suitable actions against the erring members depending upon the gravity of their offences. It is a regular and continuous on-going process. The Exchange through its monitoring and inspection departments keeps a close watch on the activity of its members. In 1991-92, disciplinary actions were taken against 75 members for various violations.

Conclusion

Indian stock exchanges, given their untapped potential and prospects of substantial growth, provide some of the best investment opportunities in the world. The legacy of a strong legal system and the evolution of a comprehensive regulatory system add to the attractiveness of the Indian stock markets. The fact that the markets during the last three to four volatile years could withstand the imposing challenges of the period without any major destabilisation is a sufficient proof of the strength of the regulatory system. There are many more challenges and problems that the regulatory agencies have to overcome but there is certainly a resolute move towards this goal of developing the Indian stock exchanges to a level comparable to the best markets in the world.

(Source: The Stock Exchange Review, November, 1992)
INSURANCE FOR CAPITAL MARKET SECURITIES *

By

M.R. Mayya,
Executive Director,
The Stock Exchange, Bombay.

It is indeed my proud privilege to address this august gathering of wizards from the banking, financial and capital market. You could not have selected a more opportune time than today to deliberate upon insurance and risk management relating to financial services.

2. I shall restrict my observations and suggestions to Insurance for Capital Market Securities and my esteemed colleague, Mr. C. Chandrashekhar, Managing Director of the Stockholding Corporation of India Limited, would be covering the topic of Securities Custodian Insurance.

3. Although the capital markets have been in existence in this country since the latter half of 18th century, and the Bombay Stock Exchange founded in the year 1875 is not only the oldest stock market in India but also in Asia, the markets did not grow appreciably as the alien government was interested in ensuring that the Indian economy acted only as an appendage to that of Great Britain. As a result, the Indian industry languished which in turn led to a negligible or marginal rate of growth of the capital market. After the dawn of Independence, the Government of India did realise that true freedom meant economic emancipation of masses, which could be achieved only through development of our own industry and trade. However, the emphasis for development was on the public sector and not on the private sector with the former attaining the commanding heights of the economy. That necessarily meant a regulatory and control-based framework for the private sector. As a result, in the post-independence period, the capital markets did not grow significantly. The development financial institutions and commercial banks played a dominant role in the Indian financial system and the capital market played only a supporting role.

4. The capital markets of the country, however, underwent dramatic changes since the beginning of 80s basically because of a progressive realisation that the command economy on which the emphasis was placed could not lead to higher levels of economic development and that a slant towards a market-oriented economy is necessary. This was done by Government gradually by opening up progressively new vistas of economic activity for the private sector. The real thrust, however, came after June, 1991 when the present Government initiated a series of measures to liberalise and to deregulate the economy. As a result, the Indian economy, which grew at a stagnant rate of 3.5 per cent in three decades after independence, registered a growth rate of 5.5 per cent in the decade of 80s. Despite a setback in 1991-92, the current decade is expected to register a growth rate of 6 to 7 per cent, if not more.

5. The growth of the economy has also led to a tremendous surge in domestic savings. The gross domestic savings which was just 10.4 per cent of the gross domestic product in 1950-51 zoomed to 23.2 per cent in 1978-79 before stagnating around 20 per cent in subsequent years. In 1991-92, however, the gross domestic savings have again shot up to 23.2 per cent of the gross domestic product and in the current year, assuming the rate of savings to be remain unaltered, the gross domestic savings will be of the order of Rs.1.45 trillion i.e. about $48 billion.

BURGEONING STOCK MARKETS

6. It is in the context of a fast expanding economy and a liberalised and deregulated atmosphere that the growth of the Indian stock market activities has to be viewed. No wonder that the markets have registered a quantum jump judged by any standards. 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 current year i.e., 1992-93, an amount of about Rs.250 billion is being raised. The number of listed companies rose over the decade from about 2,200 to over 6,500 catapulting 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 gross national product 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.

7. 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.

Ethos of Insurance in India

8. After having indicated to you how important the Indian stock markets are, let me turn to the insurance aspect vis-a-vis these markets.
9. The fast growth of the market, however, generated some thinking in this behalf and talks were held between the General Insurance Corporation of India (GIC) and Stock Exchange authorities to evolve a suitable insurance policy for capital market securities. As in several other fields, in the field of insurance also, the Bombay Stock Exchange was the first Stock Exchange in the country to take an insurance policy which became operative from 1st June, 1989. Subsequently, other Stock Exchanges have also taken similar policies.

10. The policy is effected by The New India Assurance Company Limited which is a wholly owned subsidiary of the GIC.

11. The policy which is called “Stock Exchange/Stock Brokers Insurance Policy” covers the stockbrokers’ liabilities to third parties (including the clients of the insured) in respect of completion of share transfer formalities relating to securities, viz., preference shares, equity shares and debentures. The transfer formalities in India are quite complex. The share certificate has to be accompanied by a duly stamped transfer deed, the validity of which is till the book-closure or a period of one year from the date of stamping, whichever is later. There is virtually an eight stage travel from the time the shares leave the hands of the registered shareholder and reach the hands of the transferee in whose name the shares have to be transferred.

These eight stages are as under:

(i) Selling broker sending the dated transfer deed to the registered shareholder.
(ii) The registered shareholder despatching the share certificate alongwith the transfer deed duly signed to the selling broker.
(iii) The selling broker delivering the documents to the buying broker through the clearing house of the Stock Exchange in the case of specified shares and directly to the buying broker in the case of non-specified securities.
(iv) The buying broker sending the transfer deed to the buying client for signature of the latter on the transfer deed.
(v) The buying client returning the transfer deed duly signed to the buying broker.
(vi) The buying broker lodging the documents with the company for transfer.
(vii) The company returning the share certificates to the buying broker after duly transferring the shares in the name of the buying client.
(viii) The buying broker sending the share certificate to the buying client.

12. The eight-point journey could get further lengthened if there is a bad delivery which can be for several reasons like the transfer deed not being affixed with the share transfer stamps for the requisite amount, the share transfer stamps not being cancelled, the share transfer deeds being time-barred, the transfer being in contravention of any law, the transfer being stopped by an injunction from a court or any other competent authority, the signature of the transferor not tallying with the specimen signature lodged with the company, etc. Not to mention the company not being prepared to effect the transfer or the ground that the transfer is likely to result in such change in the composition of the Board of Director of the company as would be prejudicial to the interest of the company or to the public interest.
13. The risks covered under the policy are as under:

(a) The forgery or fabrication of securities, transfer deeds, transfer receipts which may affect the registration or transfer of securities.

(b) Discovery that the securities which have been dealt in by the insured in good faith are forged or fabricated.

(c) Discovery that the insured have been deceived as to the identity of any person for the purpose of the transfer of securities registered or inscribed in books of any company or establishment, whose securities are listed on any Stock Exchange in India.

(d) Loss of securities whilst in course of transit for completion of transfer including transit by registered post or recorded delivery anywhere in India only to the extent of the cost incurred in duplicating such securities.

Risk Excluded

14. The following risks have however been excluded from the purview of the policy:

(1) Act of terrorism.

(2) Speculative activities of the insured broker.

(3) Any securities entrusted to the insured i.e. Stock Exchange or Member broker in locked boxes or other containers.

(4) Loss of market or delay or any consequential loss.

(5) Physical destruction of securities by fire, explosion, riots, strikes, lockouts and/or labour disturbances and theft for which separate insurance cover is available.

(6) Loss arising out of war, civil commotion, invasion, acts of foreign enemies, etc.

Calculation of Indemnity

The indemnity afforded to the insured in respect of any claim is calculated by estimating the value of the securities (including bonus shares and rights shares entitled thereon) as at the closing market price prevailing on the Stock Exchange where the transaction was dealt with on the day previous to the discovery of the circumstances giving rise to the liability or loss (Sundays and holidays being omitted) and if there is no such market price or value for the same on such day, then the value shall be agreed between the parties, or failing agreement, shall be referred to arbitration as may be mutually agreed upon failing which as provided for in the Arbitration Act, 1940 and adding to such value the amount of dividend, if any, declared on the aforesaid securities.

Limit of Indemnity

15. The liability of the insurer in respect of any one loss or series of losses attributable to the same cause or event shall be restricted to Rs. 500,000 per stockbroker and Rs. 10 million for the Stock Exchange as a whole in respect of all its members during the policy period of one year. The legal costs and expenses incurred by the insured in the defence or settlement of any loss is payable by the insurer subject to the total liability of the insurer to pay compensation, legal costs and expenses incurred by the insured does not exceed the indemnity limits mentioned above.
Premium Rate

16. The rate of premium payable is 1.10 per cent of the sum insured for each Stock Exchange with an additional sum of Rs. 150 per member of the Exchange. Thus with 476 members, the Bombay Stock Exchange is paying an annual premium of Rs. 181,400/-. 

Period of Cover

17. The policy is for a period of one year and normally renewed at the end of the year. If the policy is continuously in force, the insurance company is liable for any loss sustained within a period of two years prior to the date of discovery of the loss. The company is however, not liable to pay any claim in respect of losses or damage sustained prior to the inception of the original policy which in the case of the Bombay Stock Exchange was the 1st June, 1989. The insurance company is also not liable for payment of losses not sustained within the retro-active period not exceeding two years prior to the date of discovery of the loss provided, of course, the insurance policy is continuously in force subject, however, to the loss being incurred after the inception of the policy.

18. If the insurance company disclaims liability to the insured for any claim and if the insured fails to make the claim a subject matter of a suit in a court of law within 12 months from the date of disclaim, the claim shall then be deemed to have been abandoned and shall not thereafter be recoverable.

Procedure for Claims

19. The insured has to give to the insurance company immediate notice in writing of -
   (i) any claim made against the insured, or
   (ii) any circumstances of which the insured becomes aware which may subsequently give rise to a claim against the insured.

20. Such notice having been given, any subsequent claim arising therefrom shall be deemed to have been made during the subsistence of the claim. The insured has also to give to the insurance company such information as the company may reasonably require. The insured shall not admit liability for or settle any claim or incur any costs or expenses in connection with the claim without the written consent of the insurance company. The company is entitled at any time to take over and conduct in the name of the insured the defence or settlement of any claim.

Fraudulent Claim

21. If any insured member of the Stock Exchange makes any claim knowing the same to be false or fraudulent, as regards amount or otherwise, the policy would become void and all claims made by the broker shall stand forfeited in so far as the indemnity granted to that broker is concerned.

Forgery or Fabrication by Director or Partner

22. If any insured member of the Stock Exchange makes any claim arising out of forgery or fabrication committed by a director or partner of the member, the Stock Exchange is
required not only to take suitable proceedings against the member for recovery of the claim amounts from out of the assets including deposits with the Stock Exchange authorities but also take suitable disciplinary action against the member in accordance with the provisions set out in the Rules, Bye-laws and Regulations of the Stock Exchange.

Arbitration

23. In case of any difference relating to the quantum to be paid under the policy, the matter shall be referred to the decision of an arbitrator to be mutually agreed to and in case of failure to arrive at any agreement regarding the arbitration, the reference shall be made to two disinterested persons as arbitrators of whom one shall be appointed in writing by each of the parties within two calendar months after having been required to do so in writing by the other party in accordance with the provisions of the Arbitration Act, 1940. In case either party refuses or fails to appoint the arbitrator within two calendar months after receipt of notice in writing requiring an appointment, the other party shall be at liberty to appoint the sole arbitrator. In case of disagreement between the arbitrators, the difference shall be referred to the decision of an umpire who would have been appointed by them in writing before entering on the reference and who shall sit with the arbitrators and preside over their meetings.

Insurance Policy for Listed Companies

24. An insurance policy, identical to the insurance evolved for stock-brokers and Stock Exchanges, has been devised for companies whose securities have been listed on Stock Exchanges. The limit per shareholder in these policies is Rs.10,000 while the limit for the company is Rs.1 million.

Other Risks

25. The risks specifically excluded vide para 14 above do result in significant losses to the stockbrokers. The consequential losses suffered in these circumstances may include the following:

(i) Actual loss of property and/or cost of its restoration.
(ii) Loss of profit and liability to pay fixed expenses like rent, maintenance charges, salaries till the business returns to normalcy, etc.
(iii) Losses on account of contractual default for example failure to deliver shares will result in their auction at the risk and cost of defaulting member.

Loss of Securities

26. Although Mr. Chandrashekhar will deal comprehensively with custodian insurance, I may be permitted to say that a stockbroker is exposed to risk of physical loss of securities on account of theft or wrongful obstruction or removal or accidental loss or destruction from his own office or other premises where they are kept for safe custody or otherwise. Apart from the actual loss or securities and/or their restoration the consequential losses arising in such circumstances like losses arising out of contractual defaults, which may result in their auction at the risk and cost of defaulting member are also risks required to be insured.
Settlement/Counter-Party Risks

27. Stockbrokers are also exposed to settlement/counter-party risks arising out of:

(a) failure of other members of the Stock Exchange to make payment/or deliver securities in accordance with their contractual and/or settlement obligations, implement arbitration awards including those for failed trade, bad delivery of securities, auction/closing out obligations, etc., and/or due to default of a member. Losses incurred would be actual as well as due to consequential contractual defaults.

(b) default of any constituent to pay his dues or deliver securities sold/or to rectify defective documents. Losses would be actual as well as due to consequential contractual defaults.

Attachment/Injunction

28. The risk to a bonafide buyer of securities arising out of attachment or injunction or any other legal proceedings by a competent court of law or any other statutory authority prohibiting transfer of securities after they are received is also a serious risk that needs cover. The bonafide buyer may ultimately succeed in getting the prohibition on transfer vacated but it would be at a cost. In addition, the buyer is also subject to the market risks should he propose to dispose of the security in anticipation of a fall in price.

Cover for Investors

29. Insurance cover may be provided to investors against default by stock-broker and sub-brokers with regard to undisputed financial dues or delivery of securities or failure to rectify any defective documents. Similar coverage needs also to be given to a registered sub-broker in respect of his dealings with a broker.

BSE Fund

30. 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 on 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. 25,000. It is, however, expected that this amount would progressively be raised in future with the increasing flow of money into the Fund.
Cover Against Market Fluctuations Arising Out of Bad Management

31. One more risk which perhaps can not be covered is the market risk. Investment in equities and equity-related instruments is no doubt based on the theory of risk and reward and there cannot perhaps be any cover against any likely adverse movement of prices. It, however, often happens that the risk arises out of volitional bad management of companies although it is difficult to make produce proofs in this regard. This area, however, needs consideration from the point of investor protection.

Conclusion

32. As economies develop and markets get sophisticated, the role of insurance automatically gets enhanced. If the industry of insurance has not developed pari passu with the general level of development in India, it is mainly because of lack of proper education apart from the cumbersome procedure involved in realisation of claims. I am sure the seminar like the one organised by the General Insurance Corporation of India will go a long way in bridging this lacuna.

RATIONALE FOR PAYMENT OF CONTANGO CHARGES IN RESPECT OF SHORT SALES

By

M. R. Magya
Executive Director
The Stock Exchange, Bombay

Contracts for the “clearing”, popularly known as forward trading, have been going on in this country for nearly a century. This was prohibited by the Government of India on the 27th June, 1969.

Since July 1983, a type of trading known as trading in “specified shares” is being conducted at the Bombay, Calcutta, Delhi and Ahmedabad Stock Exchanges. This type of trading is almost akin to trading for the “clearing” as the facility of carrying forward the transaction from one settlement period of 14 days to another with the difference between the contract rate and the making-up price being cleared is identical to both the systems. There are at present equity shares of 94, 50, 43 and 21 companies traded as specified shares on the Bombay, Calcutta, Delhi and Ahmedabad Stock Exchanges respectively and with 45 common shares, the number of shares in which this type of trading is being actually done is 136 shares.

The rationale for providing the facility to carry forward the transaction from one settlement period of 14 days to another is that it provides to the market liquidity and breadth which in turn ensures that large purchases and sales are absorbed with narrower fluctuations in prices. Without such a facility, all purchases outstanding at the end of a settlement are required to be taken delivery of with payment for the same being made and in the like manner all sales outstanding at the end of the settlement have to result in delivery with receipt of the consideration amount. This in turn would create an illiquid and narrow market leading to sharp oscillations in prices. It is precisely because of this that movement of prices of shares in the specified group of shares is more orderly and systematic than that in the group of non-specified shares.

Mechanics of Carry Forward

The facility to carry forward the transaction from one settlement to another necessarily means that a purchaser (if he has not already offset his purchase contract by a sale contract in the course of the settlement itself) can either take delivery of the shares and pay for the same or alternatively carry forward his purchase position to the next settlement by reversing his purchase position in the current settlement by a sale transaction at the making-up price fixed by the Stock Exchange authorities (which normally is the rounded up figure of the closing quotation of the share on the last trading day
of the settlement) and paying or receiving, as the case may be, the difference between his contract price and the making-up price and creating a fresh purchase position in the next settlement. In the like manner a seller (if he has not already offset his sale contract by a purchase contract in the course of the settlement itself) can either give delivery of the shares and receive payment for the sale or alternatively carry forward his sale position to the next settlement by reversing his sale position in the current settlement by a purchase transaction at the making-up price and paying or receiving, as the case may be, the difference between his contract price and the making-up price and creating a fresh sale transaction in the next settlement.

Price for Carry Forward

The facility to carry forward the transaction necessarily means that the carry forward has to be at a price to be paid either by the buyer or the seller and this price depends upon a constantly varying set of factors like extent of outstanding position, floating stocks, returns available in alternate channels of investment, ready availability of finance, extent of short sale, etc. The short sale, amazingly contrary to the general belief, actually acts as a balancing factor in the determination of "badla" charges and this is explained in greater detail in the subsequent paras.

Explanation of ‘Vyaj Badla’ Transactions

At this juncture, it would be desirable to know as to how exactly a ‘Vyaj Badla’ or ‘Mal Badla’ transaction as is otherwise called (the word ‘Vyaj’ standing for interest and ‘Mal’ for goods) takes place. It often so happens that while the purchaser wants to carry forward his purchase position, the seller would like to give delivery of the shares. It is in this context that a badla financier who does badla from the point of view of earning interest on his finance enters the stock market. He purchases in the current settlement from the purchaser who does not want to take delivery but wants to carry forward his purchase to the next settlement, and sells the same shares to that purchaser in the next settlement, thus taking delivery of the shares in the current settlement from the seller on behalf of such purchaser. The difference between the purchase price in the current settlement and the sale price in the next settlement is the interest earned by the financier. This is known as contango, more commonly known as badla rate. These badla rates which are fixed by the market forces vary from settlement to settlement, from one scrip to another scrip in the same settlement and in the same scrip in the same settlement during the period of half an hour of the badla session.

While ‘Vyaj Badla’ is obviously done for interest and as such interest has to be paid by the original buyer to the ‘Badliwala’ who has become a seller in the ensuing settlement, but for which the ‘Badliwala’ would not have entered the stock market, the question that needs to be explained is the interest technically called contango charges that is paid to the short seller.
Backwardation Charges

A long buyer who does not want to take delivery against a genuine seller who wants to give delivery, has a saviour in the 'Badliwala'. The short seller who does not want to give delivery can, however, virtually be held to ransom by the buyer who insists on taking delivery. The short seller has then to either borrow the stocks which is not easy as stocks unlike money are not readily available or to pay interest, technically called backwardation charges, to the buyer. This is not just a theoretical proposition but an actuality in operation in the stock markets. For example, in March, 1991, the backwardation charges were as high as Rs. 160 per fortnight in the case of Hoechst India shares valued at Rs. 3,350 i.e., at the rate of 115 per cent per annum. Even recently in March 1993, backwardation charges in the case of SKF Bearing shares were as high as 93 per cent per annum. In the settlement ended on the 8th May, 1993, there were backwardation charges in respect of as many as 18 shares out of 94 shares in the specified group at rates varying from 2 per cent to 75 per cent, the average being 20.5 per cent.

Contango Charges

While backwardation charges are in operation in exceptional cases when the market is in an oversold position, contango charges are indicative of a normal market situation. Payment of contango charges is made by the buyer to the seller in lieu of the payment the buyer would otherwise be required to pay to the seller for the purchases effected by him. A buyer who is not able to pay for the shares purchased by him has necessarily to pay interest on the amount of money required for such purchases. There are also instances where a purchaser would be making badla in the stock market by paying a rate of interest which would be much lower than what his money would be earning in alternate channels of investment. This nexus between the badla rates in the stock markets and returns from alternate channels of investment brings about a close integration between the return from 'badla' finance on the one hand and the returns from other avenues of investment on the other hand. It needs to be particularly noted that all contractual obligations are frozen once the transaction is struck and the buyer is entitled for shares and all related benefits like dividend, rights and bonus attached to the contract.

Balancing of Interest Rates by Short Seller

Unlike the 'badla' financier who can dictate his returns and charge relatively a much higher rate of interest from the buyer, it is the short seller who imparts sobriety to the level of interest rate in the market and contrary to the general belief, larger the component of short sale, lower is the rate of contango charge. To illustrate this point, let us say there is a total outstanding position of say 2,00,000 shares in TISCO out of which sellers have say 1,50,000 shares ready for delivery and buyers are prepared to take delivery of say 1,00,000 shares. Outstanding position of 1 lakh sales and purchases get automatically adjusted between willing sellers and willing buyers desiring to give delivery and take delivery. The balance 50,000 shares available for delivery get apportioned among the
'Badliwalas' and the rate of contango charges is determined by the 'Badliwalas' who purchase 50,000 shares in the current settlement and sell to a corresponding extent of 50,000 shares in the ensuing settlement and the short sellers of 50,000 shares on the one hand and the long purchasers of 1,00,000 shares on the other hand. While a situation of this type may result in a contango charge of say 18 per cent, any increase in the proportion of short sale vis-a-vis the holdings of 'Badliwalas' will, ceteris paribus, lead to a contraction in the contango charges and conversely any decrease in the proportion of short sale vis-a-vis the holdings of 'Badliwalas' will result in an increase in the contango charges. This issue is, however, not so simplistic as is explained above for factors like availability of shares for actual delivery, extent of shares for actual delivery, extent of shares to be absorbed by the 'Badliwalas' and extent of short sales are constantly changing factors reacting to an ever changing dynamic situation. Complicated as the situation is, it becomes more so because each scrip has its own distinctive technical position unrelated to the other scrips and there are at present 94 scrips in the specified group at the Bombay Stock Exchange. This is precisely why there are a few scrips generally attracting backwardation charges in every settlement. The contango charges or the backwardation charges in the same scrip and in the same settlement also vary partly due to the play of the normal market forces of supply and demand during the 'badla' session normally held half an hour prior to the commencement of trading for the next settlement period and partly due to the extent of mutual trust of the buyer and the seller contracting to do 'badla'.

Malfunctioning of the Market

Besides, denial of payment of contango charges can virtually drive short sellers out of the market and their absence will lead to malfunctioning of the market. As already explained above, they narrow down the rate of interest which long purchasers would otherwise be called upon to pay. In a falling market, it is the profit-taking operations of short sellers, i.e., the purchases that they would be effecting to cover their sales, that lead to a recovery in prices. Again in a rising market, emergence of fresh short sales, can arrest a further rise.

Conclusion

From the foregoing analysis, the conclusion is obvious. A short seller is part and parcel of a forward market in securities and without him the market cannot function in an orderly and systematic way. He is entitled to contango charges just as a 'Badliwala' is entitled to. In fact, it is he who ensures that the contango charges which a buyer has to pay are contained within reasonable limits. Denial of the contango charges will drive him out of the market which in turn will adversely affect the normal working of the market.

(Source: 'The Economic Times' dated the 31st May, 1993)

(The Stock Exchange Review June 1993)
THE BOMBAY STOCK EXCHANGE
PAST, PRESENT AND FUTURE

BY
M. R. MAYYA,
EXECUTIVE DIRECTOR
THE STOCK EXCHANGE, BOMBAY

Trading in securities used to take place in India right from the close of the 18th century. After a catastrophe in the latter half of 60s of the 19th century when the markets witnessed chaotic conditions following unbridled speculative activities which resulted in unprecedented rise in prices that the stockbrokers decided in 1875 to set-up the stock exchange which was then known as the “Native Share and Stock Brokers’ Association” and which is presently also known as The Stock Exchange, Bombay. The Bombay Stock Exchange is not only the first exchange to be established in India but also in Asia as Tokyo Stock Exchange was established three years later in 1878. The exchange was granted recognition under the Bombay Securities Contracts Control Act, 1925 in May, 1927. This Act was replaced by the central legislation of Union of India, viz., The Securities Contracts (Regulation) Act, 1956 and the exchange was granted permanent recognition under the SC(R) Act on 31st August, 1957. The exchange has thus been under the direct regulatory framework of government for nearly three quarters of a century.

In its travel through the last 117 years of its existence, the Bombay Stock Exchange has weathered many a crisis emerging stronger at every juncture. While the growth during the pre-independence era and till the decade of 70s was modest, the decade of 80s saw the entire Indian stock market and the Bombay Stock Exchange in particular grow phenomenally. This can be best illustrated by certain relevant figures. The amount of capital raised from the primary market, the most of which is listed on the Bombay Stock Exchange, has increased over 60 times from about Rs. 250 crores in 1980-81 to about Rs. 16,000 crores during 1992-93. The average daily turnover on the exchange also increased from Rs.13 crores in 1981-82 to Rs. 332.30 crores in 1991-92 though it came down to Rs.229.24 crores during 1992-93. More importantly, with an average of about 40,000 deals an hour during 1991-92, Bombay Stock Exchange had the highest intensity of trading in the world next only to Taipei (Taiwan) and significantly more than that in New York, London and Tokyo.

The Bombay Stock Exchange, as it stands today, is synonymous with the Indian stock market as it accounts for over two-thirds of the secondary market trading activity spread over 21 stock exchanges in the country. Almost all the companies entering the market to raise capital make a beeline for listing on this exchange and out of about Rs. 2,25,000 crores of market capitalisation in the country, 90 per cent is listed on the Bombay Stock Exchange.
The Bombay Stock Exchange, has ever been active in expanding its activities and has broadened its scope from being an association to protect the character, status and interest of its members as was envisaged at the time of its formation, to a much broader role in ensuring a well-organized and regulated securities market that protects investors' interests and to this effect the Bombay Stock Exchange has taken several steps to meet the objectives it has set before. Some of the important landmarks achieved by the Bombay Stock Exchange during the last few years are detailed below.

Phiroze Jeejeebhoy Towers

Following the recommendation of a World Bank team in 1961, the exchange decided to construct a new building, the foundation of which was laid in 1969. The building complex comprises of 28 storeys Phiroze Jeejeebhoy Towers, which is among the tallest buildings in Bombay and a rotunda which houses the new trading ring of the exchange. This building apart from being the seat of the exchange has become a major landmark in the city for its architecture and elegance.

The Stock Exchange Official Directory

The exchange, in 1965 started the Stock Exchange Official Directory which is an eighteen volume compendium brought out on a weekly update replacement basis. It is a unique publication of its kind which covers financial and performance analysis on a ten year time-frame of more than 2,500 public limited companies and also some of the important public sector undertakings. Besides, it also has general sections covering legal framework, taxation, the state of the stock market, economic and industrial surveys, etc. The Directory, which has a global circulation, is a single point reference source and an indispensable tool for the market researchers and analysts because of the wealth of information it contains.

The Bombay Stock Exchange Sensitive Index of Equity Prices

The exchange, from the 2nd January, 1986, started publishing the Sensitive Index of equity prices based on 30 scrips from the specified and non-specified groups with 1978-79 as the base year which is looked upon today universally, both within the country and outside, as the barometer of the trend in the Indian stock market.

BSE NATIONAL INDEX

BSE National Index with 1983-84 as the base year and comprising 100 major scrips traded on Bombay, Delhi, Calcutta, Madras and Ahmedabad stock exchanges is compiled to reflect the price movement on a national level.
Both the Sensitive Index and the National Index are updated every two minutes and displayed through the PTI Stockscan.

**PTI STOCKSCAN**

A gigantic step was taken by the exchange on the 11th August, 1987 when the five major stock exchanges of the country viz., Bombay, Calcutta, Delhi, Madras and Ahmedabad were linked up for instant display of share prices, BSE Sensitive and National Indices and other market related information through large electronic boards installed on the trading floors of the exchanges and through monitors in the offices of stock brokers and others by the PTI Stockscan Service not only at these centres but at all other important cities of the country.

**BSE Times**

In June 1988, the exchange introduced a new publication entitled "BSE TIMES" (Bombay Stock Exchange Trade Information & Market Evaluation System) giving statistical and other related information on the market activity on a weekly basis. This publication has become extremely popular with the investors and others.

**The Stock Exchange Training Institute**

In January 1989, The Stock Exchange Training Institute was established to provide training facilities on the stock market and related areas initially to the stockbrokers and others interested in stock market activities and related matters. The Institute has so far successfully organised nine Stockbrokers' Studies Programmes and three Investors' Programmes training more than 900 persons. In addition, the Institute has organised a number of seminars, workshops, discussion groups, etc., discussing threadbare topical issues with concrete suggestions for improvements.

**The Stock Exchange Review**

The Stock Exchange Review is a specialised and technical monthly publication on the stock market developments and covers various areas such as articles on capital markets, international developments, economic trends, primary and secondary market analysis, price and volume data, settlement programmes, book-closures and record dates, Government notifications and guidelines, press notes, daily margins, listing of new issues, securities delisted and relisted, etc. In fact, it is a mine of information for investors, students, researchers, Government officials and all others interested in stock market activities.
P. J. Jeejeebhoy Memorial Lecture Series

The Exchange instituted in December, 1989 an annual series of lectures to commemorate the memory of late Shri P. J. Jeejeebhoy, erstwhile Chairman of this Exchange, who played a key role in the development of not only this exchange but also of the Indian capital market as a whole. Four lectures have so far been delivered, the first one being by Shri H. T. Parekh, Chairman, The Housing Development Finance Corporation Ltd., the father figure of the Indian stock market.

Price-Earnings Ratios

Price-Earnings Ratios (P/E) are increasingly used as investment analysis tools. There were no macro P/E ratios on the Indian stock market that were instantaneously available. To bridge this gap and in order to meet this need of investors, the exchange started computing the Price Earnings Ratios based on both the BSE Sensitive Index and the BSE National Index from April 1990.

Price to Book-Value & Dividend Yield Ratios

The exchange, from January, 1992, started to compile and publish on a day-to-day basis, two more important indicators, viz., price to book value (P/BV) ratio and the yield percentage in respect of the shares covered by the BSE Sensitive Index and the BSE National Index to help the investors for taking investment decisions. The P/BV ratio expresses the market price of a share in relation to its book value. It represents the market evaluation of every rupee of equity of companies and the extent to which the market value is protected by the shareholders' equity, whereas yield percentage shows the return on investment at current market prices. It is calculated as a percentage of the total equity dividends paid by the group of companies to their total market capitalisation at the point of time.

Video Film

The exchange will soon be coming out with a video film which will enlighten the investors regarding activities of the Bombay Stock Exchange.

Modernisation and Computerisation Programmes

To cope up with the surge in trading activity, which had increased from an average of 35,000 trades/day during 1988-89 to 75,000 trades/day during 1991-92, the exchange installed an ICL Series 39 mainframe computer in May, 1991. This can easily process about 1,50,000 deals a day.
Four Phased Computerisation Programme

The exchange also embarked upon a major modernisation programme in 1991 costing about Rs. 75 crores and aimed at totally transforming the trading process from the present open outcry method to one based on screen-based trading. The project has been structured into four distinct Phases as under:

Phase I: Information Dissemination

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 and 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 Display Information Driver System on display devices located in the new trading ring and at other vantage points in the exchange complex. This will soon become instantly available not only throughout the country but also throughout the world.

Phase II: Networked Settlement

Phase II is expected to be operational during the second half of 1993. It will establish a network connecting individual members' offices with the exchange 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 also be available to members through the network in Phase II.

Phase III: Automated Trading System

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 maintenance, order entry/maintenance and execution, trade reporting, information dissemination and market surveillance.

Phase IV

Phase IV, which is expected to be operational by the middle of 1995, will extend
coverage of the automated trading system to the scrips in the specified group. There will then be no trading ring in the Bombay Stock Exchange as is the case in some of the developed stock markets like London, Paris, Section II of Tokyo, Singapore and Australia.

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.

**EPABX System**

With a view to ensuring reliable and speedy communication among members and others connected with the stock exchange, an EPABX System was installed in early 1992 at a cost of Rs.1.15 crores. This will soon be expanded to cover not only the whole city but the whole country connecting all the stock exchanges, their members and the sub-brokers.

**Faster Settlements**

In ensuring faster settlements, the Bombay Stock Exchange has already introduced a weekly settlement in respect of non-specified group of securities and gradually it will be extended to cover the specified shares. Our ultimate goal is to meet the global standards of T+3 i.e., settlement on third day after the trade day as accompanied by the group of 30s. This will necessitate doing away with the physical transfer of securities at the end of every settlement as it prevails today and to usher in book-entry mode of transfer and settlement. To this effect, the Bombay Stock Exchange, has already established a BOI Share Holdings Limited in association with Bank of India which will act as a sub-depository of the Stock Holding Corporation of India Ltd. which is to act as a central depository. The stock exchange is also taking steps towards the introduction of capital adequacy norms to ensure that its members have strong financial base which is necessary to ensure that they are capable of handling greater volumes as are envisaged in future.

**NATIONAL STOCK MARKET SYSTEM**

The National Stock Market System is a system designed basically to provide in a normal course an opportunity for an investor in any part of the country to trade at the best market price in any qualified security with an investor in any other part of the country, through the members of stock exchanges, and subsequently clear and settle the trade in an efficient and cost-effective manner. This concept of the establishment of a National Stock Market System is being pursued by the Bombay Stock Exchange and for this purpose Arthur Andersen and Associates, a well known group of management consultants, have been assigned the task to prepare a comprehensive report in this regard. They have already submitted a business report in this regard while the work on technical report is presently
The process of establishment of a National Stock Market System is a long-drawn and arduous process which may become operational over a time span of between five to ten years. Other markets such as USA, UK, Germany, Japan, Australia and France also required a similar time frame to establish their respective national stock market systems. In the United States, the task of establishing a national stock market system was given to the Securities and Exchange Commission following a Congressional mandate and amendment to the Securities and Exchange Act of 1934. ITS - the National Stock Market System in the United States-is an end-result of the SEC initiative and efforts in this behalf by the New York Stock Exchange, NASDAQ and others. The national stock market system as proposed by the Bombay Stock Exchange is to be patterned on the lines of the ITS system in the United States.

**Investors' Service Cell**

The Investors' Service Cell of this exchange, which was established about a decade ago, handles currently about 10,000 complaints a month, about 98 per cent of which are against companies and tries to solve them speedily and efficiently.

**Customers' Protection Fund**

In its efforts to solve investors' problem, the Bombay Stock Exchange was the first stock exchange in the country to establish a Customers' Protection Fund in October, 1986. The Fund is financed by way of (i) a levy on the turnover of members collected at the rate of Rs. 1.50 on every Rs. 10 lakhs, (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 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.1.05 crores to its credit on the 31st March, 1993 after having distributed Rs.14.8 lakhs to the clients of defaulted members of the Exchange. Presently, a customer of a defaulting broker is presently indemnified to the extent of Rs.25,000/- against their investment losses arising out of the default of the broker. The Governing Board of the exchange decided only recently to raise this amount to Rs.40,000. This is a modest beginning and it is our desire to raise this limit substantially to say at least Rs.1,00,000 per client in the near future.

**Future Scenario**

The growth during the last decade or so, phenomenal as it was, is just only the beginning of more rapid changes envisaged in the years ahead. The on-going and irrevocable economic liberalisation pursued by the Government of India has put the stock market at the epicenter of industrial growth in the future. The Bombay Stock Exchange being the 'Numero Uno' exchange in the country will be at the heart of the future growth of the Indian
stock market. Moreover, the Indian stock markets have been gradually offered to the foreign investors first by way of off-shore mutual funds and subsequently with Global Depository Receipt issues by Indian companies in international markets and also the permission granted to registered Foreign Institutional Investors to invest in the Indian stock market. It is therefore only a matter of time when India will become an integral part of the international securities industry. There are several favourable factors to help us in this respect. The Bombay Stock Exchange, as a flagship of Indian stock market, has offered some of the highest returns among all international markets, during the last quarter of a century. Over the period from 1969 to 1992, annualised returns on the Bombay Stock Exchange in dollar terms were 14.1 per cent as against 9.7 per cent of Britain, 9.3 per cent of Japan, 7.6 per cent of France, 6.3 per cent of United States, 5.9 per cent of Canada, 5.4 per cent of Australia, 4.2 per cent of Switzerland, 3.7 per cent of Germany and global aggregates of 7.2 per cent. The ever expanding middle class in the country with purchasing capacity comparable to the developed markets is almost equal to the entire population of Europe. This itself provides a tremendous potential for industrial growth in this country and with liberal and open policies that are being pursued India will become one of the major international players in the world. The deep rooted democratic system of government with established legal and regulatory structure has given India the strong environment necessary to realise its potential. With the modernisation programmes that have already been set in motion and the on-going stress on development, the Bombay Stock Exchange will be fully geared to meet the challenges of the future. As a result of all this, the Bombay Stock Exchange will not only remain a major national stock exchange but will also become a major international stock exchange competing with the largest of the developed markets in the world. In fact, it will be the biggest stock exchange between Tokyo in the East and London in the West with state-of-art features.

(Source: Chartered Secretary's Special Issue)
ORGANISATION AND TRADING PRACTICES
OF INDIAN STOCK EXCHANGES

BY
M.R. MAYYA
EXECUTIVE DIRECTOR,
THE STOCK EXCHANGE, BOMBAY

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 catapulting 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 accompanying 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 occurrence 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 mainstay 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享受ing 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 up to 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 interest 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 entrepreneurs 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 up to 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 entrepreneurs 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 aggregate 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 consistent 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 at least 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.338.5 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 preceding 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 along with audited accounts covering, inter-alia, material changes and commitments affecting the financial position of the company which have occurred between the end of the financial year to which the balance sheet relates and the date of the report. Material changes, which have occurred during the financial year in relation to the company’s business or the class of business in which the company has an interest, is also required to be disclosed. The listing agreement requires a company to 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 occurrence 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 during 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 along with the automation of the trade. This will help reduce the period required 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 immobilisation/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 involved 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 computerising 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 transactions 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 time. 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 realised 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 default 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., (i) the investors, (ii) companies raising finance and primary market intermediaries, and (iii) the stock market brokers and intermediaries.

To the investors, it should 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 formalities 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 diligence.

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 along with 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, sub-brokers 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, underwriters, portfolio managers and investment advisors. SEBI received the following number of applications from different intermediaries.

<table>
<thead>
<tr>
<th>Category</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brokers</td>
<td>5,300</td>
</tr>
<tr>
<td>Sub-brokers</td>
<td>10,500</td>
</tr>
<tr>
<td>Non-member brokers</td>
<td>10,000</td>
</tr>
<tr>
<td>Registrars and share transfer agents (I)</td>
<td>323</td>
</tr>
<tr>
<td>Registrars and share transfer agents (II)</td>
<td>78</td>
</tr>
<tr>
<td>Debenture Trustees</td>
<td>41</td>
</tr>
<tr>
<td>Bankers to the issue</td>
<td>43</td>
</tr>
<tr>
<td>Underwriters</td>
<td>110</td>
</tr>
<tr>
<td>Portfolio Managers</td>
<td>418</td>
</tr>
<tr>
<td>Investment Advisers</td>
<td>542</td>
</tr>
</tbody>
</table>

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. Their 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 governing 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 priority 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 institutions 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 flotation 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 Corporation 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 predominantly owned (at least 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 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 accruing from transfer of these specified “Foreign Exchange Assets” are also subject to income-tax at a flat rate of 20 per cent.

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

(iii) When the total income of non-resident Indians consists solely of investment income
and/or long-term capital gains on which tax at the flat rate of 20 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 arduous 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.

(Published in the CFA Journal)
# INTERNATIONAL COMPARISON

(in million of US Dollar)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Exchange</th>
<th>Market Value Month-end December, 1992</th>
<th>Turnover during 1992</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed Markets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. New York</td>
<td>3877900.0</td>
<td>1757095.5</td>
<td></td>
</tr>
<tr>
<td>2. Tokyo</td>
<td>2254844.1</td>
<td>593780.1</td>
<td></td>
</tr>
<tr>
<td>3. Osaka</td>
<td>1955073.5</td>
<td>143234.8</td>
<td></td>
</tr>
<tr>
<td>4. London</td>
<td>954882.6</td>
<td>1773753.3</td>
<td></td>
</tr>
<tr>
<td>Emerging Markets</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Germany</td>
<td>328692.1</td>
<td>1472081.7</td>
<td></td>
</tr>
<tr>
<td>6. Mexico</td>
<td>138744.6</td>
<td>58797.1</td>
<td></td>
</tr>
<tr>
<td>7. Korea</td>
<td>107661.1</td>
<td>116795.5</td>
<td></td>
</tr>
<tr>
<td>8. Taiwan</td>
<td>100158.3</td>
<td>236683.9</td>
<td></td>
</tr>
<tr>
<td>9. India</td>
<td>85880.0</td>
<td>36260.0</td>
<td></td>
</tr>
<tr>
<td>10. Thailand</td>
<td>57278.3</td>
<td>72116.8</td>
<td></td>
</tr>
</tbody>
</table>
## Annexure II

### CAPITAL RAISED ON ALL-INDIA BASIS

(Amount in Rs. million)

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

* Provisional
<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Preference</th>
<th>Debenture</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>147.9</td>
<td>16.4</td>
<td>19.8</td>
<td>184.1</td>
</tr>
<tr>
<td>1965</td>
<td>142.5</td>
<td>22.2</td>
<td>45.2</td>
<td>209.9</td>
</tr>
<tr>
<td>1970</td>
<td>84.0</td>
<td>14.6</td>
<td>15.7</td>
<td>114.3</td>
</tr>
<tr>
<td>1971</td>
<td>47.8</td>
<td>9.3</td>
<td>5.9</td>
<td>63.0</td>
</tr>
<tr>
<td>1972</td>
<td>86.5</td>
<td>12.6</td>
<td>22.3</td>
<td>121.4</td>
</tr>
<tr>
<td>1973</td>
<td>111.9</td>
<td>8.3</td>
<td>18.2</td>
<td>138.4</td>
</tr>
<tr>
<td>1974</td>
<td>122.8</td>
<td>8.7</td>
<td>29.2</td>
<td>160.7</td>
</tr>
<tr>
<td>1975</td>
<td>76.0</td>
<td>5.9</td>
<td>36.2</td>
<td>118.1</td>
</tr>
<tr>
<td>1976</td>
<td>62.3</td>
<td>8.7</td>
<td>45.7</td>
<td>116.7</td>
</tr>
<tr>
<td>1977</td>
<td>93.1</td>
<td>2.2</td>
<td>35.4</td>
<td>130.7</td>
</tr>
<tr>
<td>1978</td>
<td>71.8</td>
<td>5.4</td>
<td>20.9</td>
<td>98.1</td>
</tr>
<tr>
<td>1979</td>
<td>127.7</td>
<td>9.5</td>
<td>42.1</td>
<td>179.3</td>
</tr>
<tr>
<td>1980</td>
<td>114.6</td>
<td>2.6</td>
<td>129.8</td>
<td>247.0</td>
</tr>
<tr>
<td>1981</td>
<td>186.1</td>
<td>1.5</td>
<td>149.6</td>
<td>337.2</td>
</tr>
<tr>
<td>1981-82</td>
<td>267.2</td>
<td>3.0</td>
<td>346.9</td>
<td>617.1</td>
</tr>
<tr>
<td>1982-83</td>
<td>268.5</td>
<td>2.4</td>
<td>462.1</td>
<td>733.0</td>
</tr>
<tr>
<td>1983-84</td>
<td>363.7</td>
<td>1.6</td>
<td>432.9</td>
<td>798.2</td>
</tr>
<tr>
<td>1984-85</td>
<td>291.5</td>
<td>0.1</td>
<td>556.8</td>
<td>848.4</td>
</tr>
<tr>
<td>1985-86</td>
<td>666.2</td>
<td>0.8</td>
<td>655.9</td>
<td>1342.9</td>
</tr>
<tr>
<td>1986-87</td>
<td>784.6</td>
<td>--</td>
<td>1326.8</td>
<td>2111.4</td>
</tr>
<tr>
<td>1987-88</td>
<td>628.9</td>
<td>--</td>
<td>515.7</td>
<td>1144.6</td>
</tr>
<tr>
<td>1988-89</td>
<td>769.2</td>
<td>--</td>
<td>1605.4</td>
<td>2374.6</td>
</tr>
<tr>
<td>1989-90</td>
<td>715.3</td>
<td>4.6</td>
<td>3078.9</td>
<td>3798.8</td>
</tr>
<tr>
<td>1990-91</td>
<td>711.5</td>
<td>7.2</td>
<td>1622.2</td>
<td>2340.9</td>
</tr>
<tr>
<td>1991-92</td>
<td>669.4</td>
<td>0.6</td>
<td>1557.5</td>
<td>2227.5</td>
</tr>
<tr>
<td>1992-93*</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>5762.7</td>
</tr>
</tbody>
</table>

* Provisional
VOLUME OF TURNOVER - BOMBAY STOCK EXCHANGE

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount in Rs. billion</th>
<th>Amount in US $ billion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Daily</td>
<td>Annual</td>
</tr>
<tr>
<td>1980-81</td>
<td>0.13</td>
<td>24.76</td>
</tr>
<tr>
<td>1981-82</td>
<td>0.38</td>
<td>68.51</td>
</tr>
<tr>
<td>1982-83</td>
<td>0.23</td>
<td>43.57</td>
</tr>
<tr>
<td>1983-84</td>
<td>0.13</td>
<td>24.88</td>
</tr>
<tr>
<td>1984-85</td>
<td>0.23</td>
<td>47.96</td>
</tr>
<tr>
<td>1985-86</td>
<td>0.35</td>
<td>74.29</td>
</tr>
<tr>
<td>1986-87</td>
<td>0.67</td>
<td>136.91</td>
</tr>
<tr>
<td>1987-88</td>
<td>0.36</td>
<td>79.13</td>
</tr>
<tr>
<td>1988-89</td>
<td>0.97</td>
<td>205.63</td>
</tr>
<tr>
<td>1989-90</td>
<td>1.35</td>
<td>293.86</td>
</tr>
<tr>
<td>1990-91</td>
<td>1.93</td>
<td>360.12</td>
</tr>
<tr>
<td>1991-92</td>
<td>3.31</td>
<td>717.77</td>
</tr>
<tr>
<td>1992-93*</td>
<td>2.38</td>
<td>456.96</td>
</tr>
</tbody>
</table>

* Provisional
### Annexure V

**BSE SENSITIVE INDEX (1978-79 = 100)**

<table>
<thead>
<tr>
<th>Year</th>
<th>High</th>
<th>Low</th>
<th>Closing</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-80</td>
<td>131.59</td>
<td>113.28</td>
<td>128.57</td>
</tr>
<tr>
<td>1980-81</td>
<td>173.44</td>
<td>121.50</td>
<td>173.44</td>
</tr>
<tr>
<td>1981-82</td>
<td>252.89</td>
<td>172.81</td>
<td>217.71</td>
</tr>
<tr>
<td>1982-83</td>
<td>236.62</td>
<td>204.66</td>
<td>211.51</td>
</tr>
<tr>
<td>1983-84</td>
<td>255.84</td>
<td>207.17</td>
<td>245.33</td>
</tr>
<tr>
<td>1984-85</td>
<td>353.86</td>
<td>233.11</td>
<td>353.86</td>
</tr>
<tr>
<td>1985-86</td>
<td>664.57</td>
<td>346.53</td>
<td>574.11</td>
</tr>
<tr>
<td>1986-87</td>
<td>658.92</td>
<td>482.41</td>
<td>510.36</td>
</tr>
<tr>
<td>1987-88</td>
<td>535.61</td>
<td>390.00</td>
<td>398.37</td>
</tr>
<tr>
<td>1988-89</td>
<td>719.07</td>
<td>397.16</td>
<td>713.60</td>
</tr>
<tr>
<td>1989-90</td>
<td>798.01</td>
<td>659.30</td>
<td>781.05</td>
</tr>
<tr>
<td>1990-91</td>
<td>1559.43</td>
<td>748.79</td>
<td>1167.97</td>
</tr>
<tr>
<td>1991-92</td>
<td>4285.00</td>
<td>1191.61</td>
<td>4285.00</td>
</tr>
<tr>
<td>1992-93</td>
<td>4467.32</td>
<td>2225.08</td>
<td>2280.52</td>
</tr>
</tbody>
</table>
## BSE SENSITIVE INDEX (1978-79 = 100)

*(In US $ Terms)*

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

BSE SENSITIVE INDEX
PRICE EARNINGS RATIO - MONTHLY AVERAGES

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>18.59</td>
<td>15.81</td>
<td>16.79</td>
<td>26.56</td>
<td>30.72</td>
</tr>
<tr>
<td>February</td>
<td>18.95</td>
<td>14.39</td>
<td>18.44</td>
<td>31.33</td>
<td>32.93</td>
</tr>
<tr>
<td>March</td>
<td>19.09</td>
<td>15.08</td>
<td>19.68</td>
<td>44.32</td>
<td>29.34</td>
</tr>
<tr>
<td>April</td>
<td>21.09</td>
<td>16.84</td>
<td>21.09</td>
<td>52.60</td>
<td>27.63</td>
</tr>
<tr>
<td>May</td>
<td>19.91</td>
<td>17.76</td>
<td>21.73</td>
<td>42.80</td>
<td>--</td>
</tr>
<tr>
<td>June</td>
<td>19.44</td>
<td>16.73</td>
<td>21.52</td>
<td>39.60</td>
<td>--</td>
</tr>
<tr>
<td>July</td>
<td>18.09</td>
<td>18.67</td>
<td>23.24</td>
<td>33.97</td>
<td>--</td>
</tr>
<tr>
<td>August</td>
<td>15.06</td>
<td>21.31</td>
<td>26.24</td>
<td>33.57</td>
<td>--</td>
</tr>
<tr>
<td>September</td>
<td>15.08</td>
<td>23.52</td>
<td>24.75</td>
<td>38.76</td>
<td>--</td>
</tr>
<tr>
<td>October</td>
<td>15.06</td>
<td>23.10</td>
<td>23.79</td>
<td>37.35</td>
<td>--</td>
</tr>
<tr>
<td>November</td>
<td>14.69</td>
<td>22.30</td>
<td>24.10</td>
<td>32.15</td>
<td>--</td>
</tr>
<tr>
<td>December</td>
<td>15.56</td>
<td>19.69</td>
<td>23.98</td>
<td>31.35</td>
<td>--</td>
</tr>
<tr>
<td>Average</td>
<td>17.62</td>
<td>19.81</td>
<td>22.31</td>
<td>36.18</td>
<td>30.16</td>
</tr>
</tbody>
</table>
### VOLATILITY IN STOCK MARKETS

PERCENTAGE RANGE OF FLUCTUATIONS OF INDEX NUMBERS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>London</td>
<td>23.8</td>
<td>21.3</td>
<td>26.4</td>
<td>20.1</td>
<td>22.6</td>
</tr>
<tr>
<td>2.</td>
<td>New York</td>
<td>25.2</td>
<td>23.7</td>
<td>24.8</td>
<td>8.4</td>
<td>18.9</td>
</tr>
<tr>
<td>3.</td>
<td>Canada</td>
<td>24.4</td>
<td>28.5</td>
<td>13.1</td>
<td>13.7</td>
<td>18.4</td>
</tr>
<tr>
<td>4.</td>
<td>Australia</td>
<td>34.6</td>
<td>29.7</td>
<td>33.9</td>
<td>21.5</td>
<td>28.3</td>
</tr>
<tr>
<td>5.</td>
<td>Japan</td>
<td>20.6</td>
<td>62.8</td>
<td>23.4</td>
<td>43.8</td>
<td>45.3</td>
</tr>
<tr>
<td>6.</td>
<td>Hong Kong</td>
<td>48.2</td>
<td>26.1</td>
<td>36.1</td>
<td>39.9</td>
<td>34.0</td>
</tr>
<tr>
<td>7.</td>
<td>Belgium</td>
<td>28.6</td>
<td>28.9</td>
<td>23.3</td>
<td>16.6</td>
<td>22.9</td>
</tr>
<tr>
<td>8.</td>
<td>France</td>
<td>33.5</td>
<td>31.7</td>
<td>24.2</td>
<td>22.9</td>
<td>26.2</td>
</tr>
<tr>
<td>9.</td>
<td>Germany</td>
<td>25.2</td>
<td>38.9</td>
<td>26.7</td>
<td>24.2</td>
<td>29.9</td>
</tr>
<tr>
<td>10.</td>
<td>Holland</td>
<td>33.2</td>
<td>21.9</td>
<td>22.3</td>
<td>12.7</td>
<td>18.9</td>
</tr>
<tr>
<td>11.</td>
<td>Italy</td>
<td>44.8</td>
<td>41.6</td>
<td>24.8</td>
<td>43.4</td>
<td>36.6</td>
</tr>
<tr>
<td>12.</td>
<td>Singapore</td>
<td>40.9</td>
<td>39.3</td>
<td>30.7</td>
<td>16.4</td>
<td>28.8</td>
</tr>
<tr>
<td>13.</td>
<td>South Africa</td>
<td>31.8</td>
<td>19.5</td>
<td>42.7</td>
<td>17.5</td>
<td>26.5</td>
</tr>
<tr>
<td>14.</td>
<td>Sweden</td>
<td>38.9</td>
<td>47.9</td>
<td>34.9</td>
<td>45.4</td>
<td>42.7</td>
</tr>
<tr>
<td>15.</td>
<td>Switzerland</td>
<td>24.0</td>
<td>31.8</td>
<td>26.3</td>
<td>20.2</td>
<td>26.1</td>
</tr>
</tbody>
</table>

**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 |

**RBI Index (All-India Industrial Securities (Ordinary Shares))**

|                | 25.0 | 56.2 | 55.9 | 67.4 | 59.8 |