CHAPTER II

PRIMARY ISSUE MARKET IN INDIA
Primary market and stock market are economically an integral part of a single market i.e. industrial securities market. Primary market is a market for new issues or new financial claims. Hence it is also called New Issue Market (NIM). The main function of new issue market is to facilitate transfer of resources from savers to the users, for which it makes issues of instruments. The savers are individuals, commercial banks and insurance companies, who are the small or individual investors and institutional investors respectively. The users are public limited companies and the government. The instruments of issues made in new issue market include the shares and debentures issued by public limited companies and the bonds that are issued by Government. Besides the savers and users, there are financial and institutional intermediaries such as lead managers and merchant bankers whose services are required in the exchanging process of instruments.

The New Issue Market has two important segments namely Initial Public Offerings (I.P.O.) and Seasonal Equity Offerings (S.E.O.) refers to cases where new companies or existing companies make public issues for the first time while S.E.O. refers to the situation where the existing
companies make further issues of previously issued class required for expansion of the firms. Though the New Market is convened with new issues only while the stock market deals with old securities, they are connected to each other. Only the new issues that are first placed in new issue market are then traded in the stock market. The stock market provides support to New Issue market by providing for transferability of shares and continuous evaluation of securities. Both the stock market and New Issue Market are inseparably connected and work in conjunction with each other. Thus the New Issue market is composed of the instruments like shares and debentures, the participants which include issuers, investors and intermediaries, the segments like I.P.O. and S.E.O. besides the other factors such as methods of floatation, mechanisms of public issue, system of regulation by government and government agencies like SEBI and also the market operating systems and practices prevailing both in the New Issue Market and the stock market. In view of the main objective of the present study to examine the present condition of I.P.O. with special reference to small investors this chapter discusses the components, their characteristics and the growth and the recent trends prevailing in the New Issue Market in general and I.P.O. in particular.

In section 2.1, the components of New Issue Market are discussed along with the development of this market. The regulatory system and framework of new issue market is outlined in section 2.2. It is followed by

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section 2.3, which analyses the developments occurred in the new issue market including the recent trends in I.P.O. market. In section 2.4, certain aspects of modern market system and practices are discussed.

2.1. COMPONENTS OF NEW ISSUE MARKET

The New Issue Market is the organisation for raising capital either for cash or the consideration other than cash and has no geographical existence. It consists of various institutions through which the savings of the community are made available to the industrial and commercial world instruments or securities.

The New Issue Market deals with the raising of fresh capital either for cash or for consideration than cash by companies. The form in which these claims are incurred are equity shares, preference shares, debentures, rights, bonus, etc.

2.1.1. EQUITY SHARES

Equity shares are commonly referred to common stocks. The term stock in the aggregate of a member's fully paid up shares of equal value merged into are fund. The stock is expressed in terms of money and it can be divided and transferred into fraction of any amount. Equity shares are the instruments right of ownership which give registered shareholders the right to vote in meeting and right to share in the profits in the form of dividends and bonus shares. Shares are issued in different forms such as sweat equity non-voting shares, rights issue shares and bonus shares.
sweat equity is issued at discount to the employees and directors of the company whose share price is 10-20 per cent above par value and for consideration other than cash for providing know-how and making available rights in the nature of intellectual property rights or value additions non-voting shares carry on voting rights and they carry additional dividend of 20 per cent higher than dividend as voting shares. Rights shares are the shares offered to the existing shareholders at a price by the company in the event of further issue of share by the company after two years from its formation date or one year from the date of first allotment. Bonus shares are issued to the existing shareholders without any payment of cash in addition to the cash dividends.

2.1.2. PREFERENCE SHARES

The preference shares are hybrid in nature with some of their features resembling the bond and others, the equity shares. They have preferential right in respect of payment of dividend and repayment of principal. Preference shares are issued in different categories namely the cumulative preference shares – with the cumulative features of unpaid and arrear dividends up to generally three years; non-cumulative preference shares having no claim over unpaid dividends. The convertible preference shares which are convertible as equity shares at the end of specified period are quasi-equity share. It gives the additional privilege of share the potential increase in the equity value. The redeemable preference shares which are redeemable when they are fully paid up, out of profits are the proceeds of a fresh issue of shares. The redeemable preference
shares which are not redeemable except an occasion like winding up of the business. In India, the shares are prohibited at present which were permitted till 15th June 1988.

Which give a regular return of 19 per cent during the gestation period from 3 to 5 years and which are convertible into equity shares as per the agreement. According to the guideline the share can be issued only for the purpose like setting up of new projects, expansion of existing projects, modernization and also working capital requirements.

2.1.3. DEBENTURE

Debenture includes debenture stock, bonds and any other securities of company, whether constituting a charge on the assets of the company or not. Debentures are generally issued by the private sector companies as a long-term promissory note for raising loan capital. The company promises to pay interest and principal as stipulated. Bonds is an alternative form of debentures in India. Public sector companies and financial institutions issue bonds.

The Redemption would be specified in the issue itself. The maturity period may range from 5 years to 10 years in India. The may be redeemed in instalments. Different Classes of Debentures are issued – Secured Debentures which is secured by a lien on the company’s specific assets; unsecured debentures which are not protected by any security. Fully convertible debenture which are converted into equity shares of the
company on the expiry of specific period. The conversion is carried out according to the guidelines issued by SEBI.

2.1.4. BOND

Bond is a long-term debt instrument that promises to pay a fixed annual sum as interest for specified period of time. Bond is an alternative form of debenture which is issued by public sector company and financial institution in India. There are different classes of bonds. Secured bond which is secured by the real assets of the issuer; unsecured bond which is not secured by the real assets of the issuer. Perpetual bond that do not mature or never mature; Redeemable bond that carry interest on capital. Fixed interest rate bonds, the interest rate of which is fixed at the time of the issue. Floating interest rate bonds, the interest rate of which changes according to the prefixed norms.

Zero Coupon bonds which are tradable at a discount and repayable at face value. Deep discount bond which is said at large discount on their normal value, the interest not payable for them and which mature at par value. Capital indexed bonds, the principal amount which is adjusted for inflation for every year.

2.1.5. WARRANTS

A warrant is a bearer document of title to buy specified number of equity shares at a specified price. Usually warrants can be exercised over a number of years. The life periods of warrants are long. Warrants are generally offered to make the bond or preferred stock offering more
attractive. Bonds may bear low interest rate but the warrants offered along with them helps the investor to enjoy the equity appreciation value. Warrants are detachable. The investor can sell the warrants separately and they are traded in the market.

The person who is holding the warrant can not enjoy the benefits of the equity holder until its conversion into equity. The price at which the warrants are converted is called exercise prices which is always greater than the current market price of the respective equity at the time of issue of warrant. There are different type of warrants – detachable warrants which are issued along with securities detachable; puttable warrants which can be sold back to the company before the issue date; and valued warrants. When warrants are issued along with hose securities detachable, they are known as detachable warrants. In some cases the warrants can be sold back to the company before the expiry date, such type is known as puttable warrants. Naked warrants are issued separately and not with any host securities. The investor has the option to convert it into equity or bond. In the New Issue Market in India, generally the securities like equity shares, preference shares, the debentures and the bonds are issued.

2.1.2. PARTICIPANTS OF NEW ISSUE MARKET

Players and Parties in the NIM

As stated earlier the parties involved in the working process of the new issue market include the savers, the investors, the borrowers of the issuing corporates the intermediaries and the regulatory agencies.
2.1.2.1. Savers and Investors – Small/Individual Investors

In India the net savers are the household sector whose savings are higher than investment while the business and corporate sectors are the borrowers as their investment is higher than the savings. In stock market, investments in securities are made by small or individual investors and institutional investor, besides foreign institutional investors also invest in the securities issued by the issuing corporates in India. The role of small investor is discussed in detail in next chapter.

2.1.2.2. Institutional Investors

The institutional investors which make investments in New Issue Market includes the investment companies such as LIC, UTI, the underwriters and financial intermediaries like merchant bankers and foreign institutional investors.

2.1.2.3. Intermediaries involved in the New Issue

In the sixties and seventies, public issue was managed by the company and its personnel. But, at present public issue involves a number of agencies. The rules and regulations, the changing scenario of the capital market necessitated the company to seek for the support of many agencies to make the public issue a success. The main agencies involved in the public issue are managers to the issue, registrars to the issue, underwriters, bankers, advertising agencies, financial institutions and government/statutory agencies.
CHART II
FINANCIAL INTERMEDIARIES IN INDIA

Organised Sector
- Capital Market Intermediaries
  - Development Banks
  - Insurance Cos (LIC & GIC)
  - UTI
  - Agri. Financing Institutions
- Money Market Intermediaries
  - RBI
  - Com.
  - Co-op.
  - P.O.
  - Govt. (Treasury Bills)

Unorganised Sector
- Money Lenders
- Indigenous Bankers
- Pawn Brokers
- Traders & Landlords

Hire Purchase Cos
- Leasing Cos
- Investment Cos
- Finance Cos
Managers to the issue lead managers are appointed by the company to manage the public issue programmes. Their main duties are (a) drafting of prospectus (b) preparing the budget of expenses related to the issue (c) suggesting the appropriate timings of the public issue (d) assisting in marketing the public issue successfully (e) advising the company in the appointment of registrars to the issue, underwriters, brokers bankers to the issue, advertising agents etc. (f) directing the various agencies involved in the public issue.

Many agencies are performing the role of lead managers to the issue. The merchant banking division of the financial institutions, subsidiary of commercial banks, foreign banks, private sector banks and private agencies are available to act as lead managers. Some of them are SBI Capital Market Ltd., Bank of Baroda, Canara Bank, DSP Financial Consultants Ltd., ICICI Securities & Finance Company Ltd. The company negotiates with the prospective managers to its issues and settles its selection and terms of appointment. Usually companies appoint lead managers with a successful background. They may be more than one manager to the issue. Some times the banks of financial institutions impose a condition while sanctioning term loan or underwriting assistance to be appointed as one of the lead managers to the issue. The fee payable to the lead managers is negotiable between the company and the lead manager. The fee agreed upon is revealed in the memorandum of the understanding filed along with the offer document.
2.1.2.4. Registrar to the Issue

After the appointment of the lead managers to the issue, in consultation with them, the Registrar to the issue is appointed. Quotations containing the details of the various functions they would be performing the charges for them are called for selection. Among them the most suitable one is selected. It is always ensured that the registrar to the issue has the necessary infrastructure like computer, internet and telephone.

The Registrars normally receive the share application from various collection centres. They recommend the basis of allotment in consultation with the Regional Stock Exchange for approval. They arrange for the despatching of the share certificates. They hand over the details of the share allocation and other related registers to the company. Usually registrars to the issue retain the issuer records at least for a period of six months from the later date of despatch of letters of allotment to enable the investors to approach the registrar for redressal of their complaints.

2.1.2.5. Underwriters

Underwriting is a contract by means of which a person gives an assurance to the issuer to the effect that the former would subscribe to the securities offered in the event of non subscription by the person to who they were offered. The person who assures is called an underwriter. The underwriters do no buy and sell securities. They stand as back-up supporters and underwriting is done for a commission. Underwriting provides an insurance against the possibility of inadequate subscription.
Underwriters are divided into two categories (i) financial institutions and banks (ii) brokers and approved investment companies. Some of the underwriters are financial institutions, commercial banks, merchant bankers, members of the stock exchange. Export and Import Bank of India, State Bank of India etc. The underwriters are exposed to the risk of non-subscription and for such risk exposure they are paid an underwriting commission.

Before appointing an underwriter, the financial strength of the prospective underwriter is considered because he has to undertake the agreed non-subscribed portion of the public issue. The other aspects considered are (a) experience in the primary market (b) past underwriting performance and default (c) outstanding underwriting commitment (d) the network of investor clientele of the underwriter and (e) his overall reputation.

The company after the closure of subscription list communicates in writing to the underwriter the total number of shares/debentures remaining unsubscribed, the number of shares/debentures required to be taken up by the underwriter. The underwriter would take up the agreed portion. If the underwriter fails to pay, the company is free to allot the shares to others or take up proceeding against the underwriter to claim damages for any loss suffered by the company for his denial.
2.1.2.6. Bankers to the Issue

Bankers to the issue have the responsibility of collecting the application money along with the application form. The bankers to the issue generally charge commission besides the brokerage, if any, depending upon the size of the public issue more than one banker to the issue is appointed. When the size of the issue is large, 3 or 4 banks are appointed as bankers to the issue. The number of collection centres is specified by the central government. The bankers to the issue should have branches in the specified collection centres. In big or metropolitan cities more than one branch of the various bankers to the issue are designated as collecting branch for acceptance of money. To create investment awareness in the minds of the people collecting branches are designated in the different towns of the state where the project is being set up. If the collection centres for application money are located nearby people are likely to invest the money in the company shares.

2.1.2.7. Advertising agents

Advertising plays a key role in promoting the public issue. Hence, the past track record of the advertising agency is studied carefully. Tentative programmes of each advertising agency along with the estimated cost and called for. After comparing the effectiveness and cost of each programme with the other, a suitable advertising agency is selected in consultation with the lead managers to the issue. The advertising agencies take the responsibility of giving publicity to the issue
on the suitable media. The media may be newspaper magazines/hoardings/press release or a combination of all.

The new issue market and stock market are economically an integral part of a single market i.e. industrial securities market. Both are susceptible to the common influence of the environmental conditions such as political stability, economic conditions, monetary policy of the Central Bank and the fiscal policy of the government. The two markets act and react upon each other in the same direction. When the stock prices go up in the market, the new issues increase and when the stock prices show a downward trend the new issues decline. The new issue market also depends on the stock exchange to find out price movements and general economic outlook and to forecast the climate for the success of new issues.²

2.1.3. FUNCTIONS OF NEW ISSUE MARKET

The main function of new issue market is to facilitate transfer of resources from savers to the users. The savers are individuals commercial banks, insurance company etc. The users are public limited companies and the government. The new issue market plays an important role of mobilizing the funds from the savers and transfer them to borrowers for production purposes, an important requisite of economic growth. It is not only a platform for raising finance to establish new enterprises but also for

expansion/diversification/modernization of existing units. In this basis the new issue market can be classified as: where firms go to the public for the first time through initial public offering (IPO) and where firms which are already trade raise additional capital through seasoned equity offering (SEO). The main function of new issue market can be divided into a triple service functions: Origination, underwriting and distribution.

2.1.3.1. Origination

Origination refers to the work of investigation, analysis and processing of new project proposals. Origination starts before an issue is actually floated in the market. There are two aspects in this function: A careful study of the technical, economic and financial viability to ensure soundness of the project. This is a preliminary investigation undertaken by the sponsors of the issue. Advisory services which improve the quality of capital issue and ensure its success. Type of issue, magnitude of issue, time of floating an issue, pricing of an issue-whether shares are to be issued at par or at premium, methods of issue, technique of selling the securities.

The function of origination is done by merchant bankers who may be commercial banks, all India financial institutions or private firms. Initially this service was provided by specialized division of commercial banks. At present, financial institutions and private firms also perform this service. Though this service is highly important, the success of the issue depends, to a large extent, on the efficiency of the market. The origination
itself does not guarantee the success of the issue. Underwriting, a specialized service is required in this regard.

2.1.3.2. Underwriting

Underwriting is an agreement whereby the underwriter promises to subscribe to a specified number of shares or debentures or a specified amount of stock in the event of public not subscribing to the issue. If the issue is fully subscribed then there is no liability for the underwriter. If a part of share issue remain unsold, the underwriter will buy the shares. Thus underwriting is a guarantee for the marketability of shares.

The underwriter guarantees the sale of a specified number of shares within a specified period. If the public do not subscribe to the specified amount of issue, the underwriter buy the balance in the issue. The underwriter makes outright purchase of shares and resell them to the investors. Underwriting is jointly done by a group of underwriters. The underwriters form syndicate for this purpose. This method is adopted for large issues. The institutional underwriters include Life Insurance Corporation of India (LIC), Unit Trust of India (UTI), Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), Commercial banks and Insurance companies.
2.1.3.3. Distribution

Distribution is the function of sale of securities to ultimate investors. This service is performed by brokers and agents who maintain regular and direct contact with the ultimate investors. The various methods which are used in the floatation of securities in the new issue market are: Public issues, Offer for sale, Placement, Rights issue.

2.1.3.4. Public Issues

Under this method, the issuing company directly offers to the general public/institutions a fixed number of shares at a stated price through a document called prospectus. This is the most common method followed by joint stock companies to raise capital through the issue of securities. The prospectus must state the following:

1. **Name of the company**
2. **Address of the registered office of the company**
3. **Existing and proposed activities**
4. **Location of the industry**
5. **Names of Directors**
6. **Authorised and proposed issue capital to the public**
7. **Dates of opening and closing the subscription list**
8. **Minimum subscription**
9. **Name of brokers/underwriters/bankers/managers and registrars to the issue.**
10. **A statement by the company that it will apply to stock exchange for quotations of its shares.**
According to the Companies Act, 1956 every application form must be accompanied by a prospectus. Now, it is no longer necessary to furnish a copy of the prospectus along with every application form as per the Companies Amendment Act, 1988. Now an abridged prospectus, is being annexed to every share application form.\(^3\)

Sales through prospectus has the advantage of inviting a large section of the investing public through advertisement; allotting to a large section of investors on a non-discriminatory basis without involvement of intermedicines like brokers; It quickens process of dispersion of shares and also of avoiding concentration of wealth in few hands.

This method is suitable only for large issue as the company has to incur expenses on printing of prospectus, advertisement, bank’s commission, underwriting commission, legal charges, stamp duty listing fee and registration charges. Public issue through prospectus is discussed in detail in later portion of this chapter which explains the issue characteristics, issuers characteristics and the SEBI’s norms and guidelines involved therein.

2.1.3.5. Offer of Sale

The method of offer of sale consists in outright sale of securities through the intermediary of issue Houses or Share brokers. In other

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In words, the shares are not offered to the public directly. It consists of two stages: The first stage is a direct sale by the issuing company to the Issue House and Brokers at an agreed price. In the second stage, the intermediaries resell the above securities to the ultimate investors. The Issue Houses or stock brokers purchase the securities at a negotiated price and resell at a higher price. The difference in the purchase and sale price is called turn or spread.

The company is relieved from the problem of printing and advertisement of prospectus and making allotment of shares. Offer of sale is not common in India.

2.1.3.6. Placement

Under this method, the Issue Houses or brokers buy the securities outright with the intention of placing them with their clients afterwards. Here the brokers act as almost wholesalers selling them in retail to the public. The brokers would make profit in the process of reselling to the public. The Issue Houses or brokers maintain their own list of clients and through customer contact sell the securities.

Timing of issue is important for successful floatation of shares. In a depressed market conditions when the issues are not likely to get public response through prospectus, placement method is a useful method of floatation of shares and this method is suitable when small companies issue their shares.
The securities are not widely distributed to the large section of investors while selected group of small investors are able to buy a large number of shares and get majority holding in a company.

This method of private placement is used to a limited extent in India. The promoters sell the shares to their friends, relatives and well wishers to get minimum subscription which is a precondition for issue of shares to the public.

2.1.3.7. Rights Issue

Right issue is a method of raising funds in the market by an existing company. A right means an option to buy certain securities at a certain privileged price within a certain specified period. Shares, so offered to the existing shareholders are called rights shares. Rights shares are offered to the existing shareholders in a particular proportion to their existing share ownership. The ratio in which the new shares or debentures are offered to the existing share capital would depend upon the requirement of capital. The rights themselves are transferable and saleable in the market.

Section 81 of the Companies Act deals with rights issue. According to this section, where a company increases its subscribed capital by the issue of new shares either after two years of its formation or after one year of its first issue of share whichever is earlier, these have to be first
offered to the existing shareholders with the right to reserve them in favour of a nominee.

A Company issuing rights is required to send a circular to all existing shareholders. The circular should provide information on how additional funds would be used and their effect on the earning capacity of the company. The company should normally give a time limit of at least one month to two months to shareholders to exercise their rights. If the rights are not fully taken up, the balance is to be equitably distributed among the applicants for additional shares. Any balance still left over may be disposed of in the market in a way which is most beneficial to the company.

The minimum cost of issue (with the absence of underwriting brokerage, advertising and printing expenses) equitable distribution of shares to all existing shareholders and the prevention for issue and transfer of shares by directors to their personally interested circles are the chief merits of this type of issue.

2.2. REGULATORY FRAME WORK

Stock market regulation was a pre-independence phenomenon in India. During the II World War period, in the Defence Rules of India, 1943, provisions were made to check the flow of capital into production of essential commodities. These rules, which were promulgated as a temporary measure continued after the war and culminated into the Capital Issues Control Act, 1947.
2.2.1. CAPITAL ISSUES CONTROL ACT 1947

The main objectives of this Act were as follows:

i) To channelize balanced investment of resources in accordance with objectives of the Five Year Plan (Relating to macro-economic goals).

ii) To further the growth of companies with sound capital structure and to promote a rational and healthy expansion of the corporate sector in general public interest (Relating to corporate governance).

iii) To direct and distribute public issues of capital in a balanced manner (Relating to allocative efficiency).

iv) To regulate bonus issues and to control pricing of issues (Relating to corporate governance).

v) To regulate the capital organisation plans of companies including mergers and amalgamations necessitating issue of capital (Relating to corporate governance).

2.2.2. CONTROLLER OF CAPITAL ISSUES (CCI)

For the purpose of achieving the above objectives, an office of the Controller of capital issues was set up. It was entrusted with the responsibility of regulating the capital issues in the country. The CCI was vested with the powers to approve the kind of instruments, size, timing and premium of issue. Almost every aspect of the firms activities such as the volume and nature of applications coming up for consent the technical and financial collaboration required, the criteria for industrial licensing and provisions' and objectives of company law and stock exchange of guidelines came under its purview. The CIC Act reflects the repressive
policy measures pursued by the Government. No non-government i.e., private enterprise could raise capital in the market without prior consent of the CCI. The CIC Act covered a wide range of activities starting from guidelines for new share capital, issue, bonus, issue, employees stock option, debentures by public limited companies, rights debentures, cumulative convertible preference shares, over subscription retention and a myriad of related activities.

2.2.3. SECURITIES CONTRACTS (REGULATIONS) ACT

It was proved over time that the provisions in the Capital Issues (Control) Act were totally inadequate to regulate the growing dimensions of capital market activities. The Government realized the necessity of creating a broad based and a more secure environment for the business to grow. This led to the enactment of Companies Act and Securities Contracts (Regulation) Act in 1956. These legislations contained several provisions relating to the issue of prospectus, disclosure of accounting and financial information, listing of securities etc.

The growth of securities market, during the Sixth Five Year Plan period, the number of malpractices was imported in both the primary and secondary markets. Some of the malpractices were manipulation security prices. Price-rigging, insider trading, delay in settlement and delay in listing and commencement of trading in shares. Manipulation of security prices refers to the artificial pushing up the prices before the issue of securities. Price-rigging refers to common way of pushing of the prices to resort to circular trading, inside trading was employed by the insiders who were privy to price sensitive information use such information to their
advantage. Delay in settlement, listing and commencement of trading in shares. All were employed by the using corporates to keep the artificial high prices in the market at the initial levels.

Besides, the Indian Stock Markets was affected with the deficiency problems such as lack of diversity in Financial Instruments, Inadequate disclosure of Financial instruments, poor liquidity, and lack of control over speculative minded brokers.

2.2.4. COMPANIES ACT OF 1956

One of the most important laws in corporate legislation is the companies Act of 1956 which has far reaching and all-pervading effect on the Indian industry. It was enacted with the explicit objective of controlling and regulating every conceivable facet of the corporate sector. Its inception was in the nineteenth century in 1850 when the Act was first promulgated initiated joint stock company business in India. The 1850 Act was changed and amended several times in 1857, 1866, 1882, 1913, 1938, 1942 and in 1949. It was earlier known as the Indian Companies Act. These amendments were made as and when the need arose. The 1956 Act was drafted retaining certain sections of the earlier Act and incorporating a whole new spectrum of legislation that would correspond to independent India’s socialistic ideas and policies.

While part I contains the preliminaries mostly, definitions, the part II of the Act relates to the incorporation of the companies its Articles of Association, and memorandum of association and registration of companies. Part III is relevant to the capital market as it relates to the
firm's issue of capital activity, i.e., regarding prospectus allotment, and other matters relating to issue of shares and debentures. Some important provisions relate to prospectus issue and material information, the mis-statements in prospects, criminal liability for mis-statements on prospectus, penalty for fraudulently inducing persons to invest money and finally purchase by a company of its own shares that is buy back provision. Part IV relates to share capital and debentures with regard to type, numbering certificate of share, share capital etc.

As it was realized by political lenders and policy decision makers of India that companies Act of 1956 could not fulfil the functions appropriately under the new policy regime of liberalisation and market orientation. In 1993 the companies Bill was drafted.

2.2.5. FOREIGN EXCHANGE REGULATION ACT OF 1973 (FERA)

Though this Act is not concerned directly with the regulation of stock market, it has significant impact is the functions and growth of primary market in India. The explicit objective of FERA was to control the out-flow of foreign exchange. The most important section of this Act relevant to the capital market contain the clauses which aimed at reducing the holding of an control of foreigners over Indian companies operating on Indian oil. The Overseas Corporated Bodies (OCB) has been remitting massive amounts of foreign promoters and shareholders abroad. Instead of closing such concerns which would be detrimental to the economy, these companies were required to bring down their holdings to 40 per cent. This was a watershed for the Indian capital market. Companies desirous of continuing operation in India diluted their share holdings by offering their
shares to the Indian public. Except for banking and tea companies most firms with majority foreign holding disinvested. Members of the Indian public became the new owners. While this led to a huge spurt in capital market activity, it gave the Indian citizens an opportunity to enjoy benefits of the highly profitable multinational companies. The FERA had a slightly dampening impact on foreign collaboration and transfer of technology, while it caused a landslide of public issues in the seventies. It stimulated awareness of the stock market among the public, as the Government gradually liberalized it’s policies, and the capital market grew at an exponential rate. This committee observes mention here in view of the fact the terms of reference of the committee include, among other matters, the new issues and listing arrangements and investor protection and services. In May, 1984 a high powered committee under the chairmanship of G.S. Patel was set up to make comprehensive review of the functioning of the stock exchange.

To infuse professionalism into the organizational system the committee recommended non brokers representation in the stock exchange managing committee, and the Executive Director and President to have no direct link with trading activity. This was to prevent exploitation of their privileged position having access to sensitive information, which is the main cause for insider trading. A most important recommendation was regarding improvement of the regulatory environment; to have establishing an independent supervisory body modeled on the SEC of USA to monitor in the market. The committee favoured the establishment of a statutory body with adequate powers
embodied in the statute to for it to function effectively. This was the
genesis of the SEBI, which is the regulatory authority today.

To enhance the levels of information available to investors the
committee recommended that half yearly-unaudited accounts be published
in the media to keep shareholders and prospective investors informed, this
was a major step towards initiating disclosure norms for of investor
protection in the Indian Capital Market. Most of the recommendations
given by the GSPC were adopted by the leading stock exchanges, yet
much remains to be done. The most significant step taken by the
Government to eliminate repressive policies and usher market orientated
policies was establishment of the Securities Exchange Board of India
(SEBI).4

2.2.6. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)
ACT 1992

In the circumstances, of the growth of capital market with
operation deficiency and limitations, the 1987-88 Union budget proposed
to constitute a separate board for the regulation and orderly functioning of
security industry. The securities exchange board of India was constituted
in April, 1988 as a non-statutory body by a resolution passed by the
Government of India, the Department of Economic Affairs Ministry of
Finance. In 1992 the SEBI Act 1992 charged to SEBI with comprehensive
power over practically all aspects of capital market operations.

4 Montek, S. Ahluwalia, India : A Financial Sector for Twenty-first
The main objectives of SEBI is the protection of interest of investor by improving the efficiency of the market and also the intermediaries functioning in the market its functions are two-fold in nature viz., regulatory function which includes regulations of stock exchange self regulatory organisations and of stock-brokers, registrar to issue, merchant bankers, underwriters, portfolio managers and other intermediaries.

The Development functions of include promoting investors of education, training of intermediaries, conducting research and promotion of fair practices and self regulatory organisations. The objectives and functions of SEBI imply that the markets have ensured fairness. The markets must promote integrity in dealings, high standards of conduct and good business practice.

SEBI has issued number of guidelines, for primary market besides, the secondary market mutual funds, merchant bankers, foreign institutional investors, investor protection etc. The SEBI guidelines for the constituents of new issue market namely, the new companies, new companies formed by the existing companies are discussed in the later portion of this chapter.

In SEO market, firms which are already existing and trading raise additional capital through Seasoned Equity Offerings in the form of right shares and the bonus shares. IPO market refers the case were firms go public for the first time through Initial Public Offerings and the Equity is main instrument of issue which is made by the new company and also by the New Companies which are formed by the existing companies which
go for public for the first time. The major issues are the public companies and public sector enterprises.

2.2.7. **SEBI'S ROLE IN IPO MARKET**

As SEBI was formulated with aim of protecting the investors, promoting and regulating the securities market, several measures have been undertaken by SEBI. Entry and disclosures norms are tightened to prevent the exploitation of investors by unscrupulous promoters. Allocation of shares and promoters contribution are regulated.

2.2.7.1. **SEBI Guidelines**

SEBI has issued guidelines in the areas of primary market in this regard to.

2.2.7.2. **New Company**

A new company is one (a) which has not completed 12 months commercial production and does not have audited results and (b) where the promoters do not have a track record. These companies will have to have shares only at par.

2.2.7.3. **New Company set up by Existing company**

When a new company is being set up by existing companies with a five year track record of consistent profitability and a contribution of atleast 50 per cent in the equity of new company, it will be free to price its issue i.e., it can issue its share at premium.
2.2.7.4. Private and closely held companies

The private and closely held companies having a track record of consistent profitability for at least three years, shall be permitted to price their issues freely. The issue price shall be determined only by the issues in consultation with lead managers to the issue.

2.2.7.5. Existing Listed Companies

The existing listed companies will be allowed to raise fresh capital by freely pricing expanded capital provided the promoter’s contribution is 50 per cent in first Rs.100 crores of issue, 40 per cent in next Rs.200 crores, 30 per cent on next Rs.300 crores and 15 per cent on balance issue amount.

2.2.7.6. Reservation of issues

Reservation under public subscription for various categories of persons is made in the following manner:

1. Permanent employees - 10%
2. Indian Mutual Funds - 20%
3. Foreign Institutional Investors - 15%
4. Development Financial Institutions - 20%
5. Share holders of group of companies - 10%

2.2.7.7. Composite Issues

In the case of composite issue i.e., right cum public issue by existing listed companies differential pricing shall be allowed. In otherwords, issue to the public can be priced differentially as compared to
issue to right shareholders. However, justification for the price difference should be given in the offer document.

2.2.7.8. Lock in period

Lock in period is five years for promoter’s contribution from the date of allotment or from the commencement of commercial production whichever is late.

2.2.7.9. Public Issue

1. Abridged prospectus has to be attached with every applications.
2. A company has to highlight the risk factors in the prospectus.
3. Objective of the issue and cost of project should be mentioned in the prospectus.
4. Company’s management, past history and present business of the firm should be highlighted in the prospectus.
5. Particulars in regard to company and other listed companies under the same management which made any capital issues during the last three years are to be stated in the prospectus.
6. Justification for premium, in the case of premium is to be stated.
7. Subscription list for public issues should be kept open for a minimum of three days and a maximum of 10 working days.
8. The collection centers should be atleast 30 which include all centers with stock exchanges.
9. Collection agents are not to collect application money in cash.
10. The quantum of issue, whether through a right or public issue, shall not exceed the amount specified in the prospectus. No retention of over subscription is permissible under any circumstances.
11. A compliance report in the prescribed form should be submitted to SEBI within 45 days from the date of closure of issue.

12. Minimum number of shares per application has been fixed at 500 shares of face value of Rs.100.

13. The allotments have to be made in multiples of tradable lot of 100 shares of Rs.10 each.

14. Issues by way of bonus, rights etc. to be made in appropriate loss to minimize odd loss.

15. If minimum subscription of 90 per cent has not been received the entire amount is to be refunded to investors within 120 days.

16. The capital issue should be fully paid up within 120 days.

17. Underwriting has been made mandatory.

18. Limit of listing of companies issue in the stock exchange has been increased from Rs.3 crores to Rs.5 crores.

19. The gap between the closure dates of various issues viz. rights and public should not exceed 30 days.

20. Issues should make adequate disclosure regarding the terms and conditions of redemption, security convers in and other relevant features of the new instruments so that an investor can make reasonable determination of risks, returns, safety and liquidity of the instrument. The disclosure shall be vetted by SEBI in this regard.5

2.3. GROWTH OF NEW ISSUE MARKET IN INDIA

2.3.1. QUALITATIVE DEVELOPMENTS

The Indian capital market could achieve remarkable growth in quantitative terms after three decades of Independence of India. This section pays attention to the area of growth of New Issue Market upto eighties in India.\(^6\)

The capital market was in dormant stage during the decades of fifties, sixties and most of seventies. During this period, the investors in general were not familiar or interested in corporate securities. As the market was dominated by few but large institutions like UTI and LIC, there was a high degree of concentration of trading of a few cleared scrips. The volume of trading was small. Equity investors were in general under compensated for the risk borne by them. There was no significant development and growth in New Issue Market.

In the late seventies dilution in FERA was effected and it had led to spurt in new issues in the market. The investor in capital market opportunities was stimulated. This period is said to be the growth period considering the increased number of issues and volume of capital traded in the market. The real growth in capital market occurred from mid-eighties in the wake of liberalization initiatives of the government which continued in nineties also. The Table 2.1 shows the trend of capital issues by the private corporate sector as a percentage of Gross Domestic savings. The capital issues increased from 5.09 in 1960 to 6.38 in 1990 through it had

\(^6\) Prasanna Chandra, \textit{Investment Game How to win}, Sultan Chand, New Delhi, 1994.
declining trend upto 1981 except few years. During this decade millions of new investors entered the capital market the new issues multiplied in several fold and the companies approached the capital market freely. Table 2.2 shows that capital through equity, which accounted for nearly 90 per cent of total capital issued in 1960 declined to less than 50 per cent in 1980 and for the first time capital issues through debt exceeded equity issues. During the period from 1957 to 1990 capital issues through right issues dominated the public issues. Significantly, the equity investors in general, were overcompensated for the risk borne by them. manipulative practices thrived and speculative fever gripped the market. As in the case of New Issues Market, the capital market activity expanded rapidly in the 1980s, the market capitalisations of companies registered in the BSE rose from 5 per cent of GDP in 1980s to 13 per cent in 1990. However, the market remained primitive and poorly regulated. Companies wishing to access the capital market needed prior permission of the government which also had to approve the price at which new equity could be raised. While new issues were strictly controlled, there was inadequate regulation of stock market activity and also of various market participants including stock exchanges, brokers, mutual funds etc. The domestic capital market was also closed to portfolio investment from abroad except through a few close ended mutual funds floated by the Unit Trust of India (UTI) which were dedicated to Indian investment.
Table 2.1
Capital Issues by the Private Sector (Rs. in Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Debt</th>
<th>Total</th>
<th>As % in GDS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>80.4</td>
<td>9.4</td>
<td>89.8</td>
<td>5.09</td>
</tr>
<tr>
<td>1961</td>
<td>88.6</td>
<td>12.4</td>
<td>101.0</td>
<td>4.90</td>
</tr>
<tr>
<td>1962</td>
<td>78.4</td>
<td>29.9</td>
<td>108.3</td>
<td>5.17</td>
</tr>
<tr>
<td>1963</td>
<td>71.2</td>
<td>23.0</td>
<td>94.2</td>
<td>3.80</td>
</tr>
<tr>
<td>1964</td>
<td>83.7</td>
<td>11.5</td>
<td>95.2</td>
<td>3.37</td>
</tr>
<tr>
<td>1965</td>
<td>81.0</td>
<td>21.7</td>
<td>102.7</td>
<td>3.28</td>
</tr>
<tr>
<td>1966</td>
<td>63.3</td>
<td>15.3</td>
<td>78.6</td>
<td>2.07</td>
</tr>
<tr>
<td>1967</td>
<td>64.7</td>
<td>21.6</td>
<td>86.3</td>
<td>1.91</td>
</tr>
<tr>
<td>1968</td>
<td>68.4</td>
<td>28.0</td>
<td>96.4</td>
<td>2.14</td>
</tr>
<tr>
<td>1969</td>
<td>63.0</td>
<td>33.3</td>
<td>96.3</td>
<td>2.05</td>
</tr>
<tr>
<td>1970</td>
<td>76.7</td>
<td>14.8</td>
<td>91.5</td>
<td>1.51</td>
</tr>
<tr>
<td>1971</td>
<td>78.7</td>
<td>8.7</td>
<td>87.4</td>
<td>1.29</td>
</tr>
<tr>
<td>1972</td>
<td>97.7</td>
<td>51.7</td>
<td>149.4</td>
<td>1.99</td>
</tr>
<tr>
<td>1973</td>
<td>98.6</td>
<td>14.9</td>
<td>113.5</td>
<td>1.45</td>
</tr>
<tr>
<td>1974</td>
<td>107.2</td>
<td>23.8</td>
<td>131.0</td>
<td>1.15</td>
</tr>
<tr>
<td>1975</td>
<td>68.3</td>
<td>30.1</td>
<td>98.4</td>
<td>0.77</td>
</tr>
<tr>
<td>1976</td>
<td>65.8</td>
<td>40.5</td>
<td>106.3</td>
<td>0.71</td>
</tr>
<tr>
<td>1977</td>
<td>82.0</td>
<td>29.1</td>
<td>111.1</td>
<td>0.62</td>
</tr>
<tr>
<td>1978</td>
<td>92.6</td>
<td>50.0</td>
<td>142.6</td>
<td>0.70</td>
</tr>
<tr>
<td>1979</td>
<td>108.5</td>
<td>33.3</td>
<td>141.8</td>
<td>0.59</td>
</tr>
<tr>
<td>1980</td>
<td>92.9</td>
<td>102.9</td>
<td>195.8</td>
<td>0.79</td>
</tr>
<tr>
<td>1981</td>
<td>170.3</td>
<td>130.7</td>
<td>301.0</td>
<td>1.05</td>
</tr>
<tr>
<td>1982</td>
<td>124.9</td>
<td>286.7</td>
<td>411.6</td>
<td>1.23</td>
</tr>
<tr>
<td>1983</td>
<td>155.5</td>
<td>616.2</td>
<td>771.7</td>
<td>2.27</td>
</tr>
<tr>
<td>1984</td>
<td>244.7</td>
<td>664.9</td>
<td>909.6</td>
<td>2.33</td>
</tr>
<tr>
<td>1985</td>
<td>244.7</td>
<td>613.6</td>
<td>858.3</td>
<td>2.04</td>
</tr>
<tr>
<td>1986</td>
<td>899.6</td>
<td>845.7</td>
<td>1745.3</td>
<td>3.51</td>
</tr>
<tr>
<td>1987</td>
<td>1008.2</td>
<td>1555.7</td>
<td>2563.9</td>
<td>4.49</td>
</tr>
<tr>
<td>1988</td>
<td>1109.8</td>
<td>667.3</td>
<td>1777.1</td>
<td>2.55</td>
</tr>
<tr>
<td>1989</td>
<td>1036.9</td>
<td>2187.9</td>
<td>3224.8</td>
<td>3.78</td>
</tr>
<tr>
<td>1990</td>
<td>1228.1</td>
<td>5218.8</td>
<td>6509.9</td>
<td>6.38</td>
</tr>
</tbody>
</table>

### Table 2.2

Capital Issues: 1957 to 1989-90 (Rs. in Crore)

<table>
<thead>
<tr>
<th>Year</th>
<th>Public</th>
<th>Rights</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1957</td>
<td>12.05</td>
<td>55.99</td>
<td>68.4</td>
</tr>
<tr>
<td>1958</td>
<td>13.94</td>
<td>14.56</td>
<td>55.50</td>
</tr>
<tr>
<td>1959</td>
<td>27.64</td>
<td>43.92</td>
<td>71.56</td>
</tr>
<tr>
<td>1960</td>
<td>29.80</td>
<td>60.48</td>
<td>90.28</td>
</tr>
<tr>
<td>1961</td>
<td>37.27</td>
<td>61.65</td>
<td>98.92</td>
</tr>
<tr>
<td>1962</td>
<td>31.87</td>
<td>75.38</td>
<td>107.25</td>
</tr>
<tr>
<td>1963</td>
<td>45.09</td>
<td>49.68</td>
<td>94.76</td>
</tr>
<tr>
<td>1964</td>
<td>32.28</td>
<td>69.89</td>
<td>102.17</td>
</tr>
<tr>
<td>1965</td>
<td>32.73</td>
<td>69.89</td>
<td>102.62</td>
</tr>
<tr>
<td>1966</td>
<td>27.25</td>
<td>51.38</td>
<td>78.63</td>
</tr>
<tr>
<td>1967</td>
<td>19.55</td>
<td>66.74</td>
<td>86.29</td>
</tr>
<tr>
<td>1968</td>
<td>15.30</td>
<td>80.58</td>
<td>95.88</td>
</tr>
<tr>
<td>1969</td>
<td>17.10</td>
<td>75.57</td>
<td>92.67</td>
</tr>
<tr>
<td>1970</td>
<td>34.38</td>
<td>55.03</td>
<td>89.41</td>
</tr>
<tr>
<td>1971</td>
<td>33.29</td>
<td>54.09</td>
<td>87.38</td>
</tr>
<tr>
<td>1972</td>
<td>45.31</td>
<td>104.08</td>
<td>149.39</td>
</tr>
<tr>
<td>1973</td>
<td>39.32</td>
<td>74.11</td>
<td>113.43</td>
</tr>
<tr>
<td>1974</td>
<td>28.41</td>
<td>102.58</td>
<td>130.99</td>
</tr>
<tr>
<td>1975</td>
<td>33.95</td>
<td>64.49</td>
<td>99.44</td>
</tr>
<tr>
<td>1976</td>
<td>30.00</td>
<td>76.33</td>
<td>106.33</td>
</tr>
<tr>
<td>1977</td>
<td>51.99</td>
<td>59.13</td>
<td>111.12</td>
</tr>
<tr>
<td>1978</td>
<td>23.65</td>
<td>56.64</td>
<td>80.29</td>
</tr>
<tr>
<td>1979</td>
<td>60.44</td>
<td>81.32</td>
<td>141.76</td>
</tr>
<tr>
<td>1980</td>
<td>26.07</td>
<td>169.70</td>
<td>195.77</td>
</tr>
<tr>
<td>1981</td>
<td>72.23</td>
<td>234.58</td>
<td>306.81</td>
</tr>
<tr>
<td>1982</td>
<td>73.95</td>
<td>337.64</td>
<td>411.59</td>
</tr>
<tr>
<td>1983</td>
<td>165.60</td>
<td>505.97</td>
<td>671.57</td>
</tr>
<tr>
<td>1984</td>
<td>244.60</td>
<td>613.61</td>
<td>858.29</td>
</tr>
<tr>
<td>1985</td>
<td>418.20</td>
<td>739.16</td>
<td>1157.36</td>
</tr>
<tr>
<td>1986</td>
<td>611.18</td>
<td>1727.49</td>
<td>2338.67</td>
</tr>
<tr>
<td>1987</td>
<td>242.34</td>
<td>360.40</td>
<td>602.74</td>
</tr>
<tr>
<td>1988</td>
<td>979.55</td>
<td>2219.75</td>
<td>3199.30</td>
</tr>
<tr>
<td>1989-90</td>
<td>522.89</td>
<td>2110.11</td>
<td>2633.00</td>
</tr>
</tbody>
</table>

2.3.2. DEVELOPMENT OF NEW ISSUE MARKET IN THE DECADE OF NINETIES

Economic liberalisation, privatisation, foreign private participation, disinvestments in public sector and regulatory changes provided a new impetus to the capital market.

The amount of funds raised from the primary market was only Rs.910 crore in 1983-84. The number of issues made and the amount raised from the market has been phenomenal in the last decade. Table 2.3 shows the number of issues made and the amount raised from 1990-91 to 1996-97.

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of issues</th>
<th>Amount (Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>141</td>
<td>1,704.35</td>
</tr>
<tr>
<td>1991-92</td>
<td>196</td>
<td>1,711.36</td>
</tr>
<tr>
<td>1992-93</td>
<td>528</td>
<td>6,060.82</td>
</tr>
<tr>
<td>1993-94</td>
<td>770</td>
<td>12,544.04</td>
</tr>
<tr>
<td>1994-95</td>
<td>1343</td>
<td>13,311.60</td>
</tr>
<tr>
<td>1995-96</td>
<td>1428</td>
<td>10,981.72</td>
</tr>
<tr>
<td>1996-97</td>
<td>753</td>
<td>11,648.00</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The amount of public issue which was only Rs.1704.35 crore in 1990-91 increased to a peak of Rs.13,311.60 crore in 1994-95. In the last
four years the public issue has increased at an annual average of Rs.12,000 crore.

There has been a decline in the amount of money raised from the primary market during the last two years. The number of issues rose in 1995-96 which indicates that most of the issues were of small size. The number of issues fell drastically by 47 per cent to 753 in 1996-97. The primary market performance was dismal in 1997-98.

The public sector organisations like Financial Institutions, public sector undertakings have started dominating the primary market. They collectively raised Rs.7,539 crores or 65 per cent of the year 1996-97, total mobilisation. The year 1996-97 witnessed almost all financial institutions joining the fray including Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India and many public sector banks who mobilized resources through public issue route.

2.3.2.2. Response to public issue

The response to public issue from the year 1993-94 to 1996-97 is shown in Table 2.4.
Table 2.4
Response to Public issue

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.5 times and below</td>
<td>56</td>
<td>23</td>
<td>62</td>
<td>91</td>
</tr>
<tr>
<td>1.5 times to 3</td>
<td>17</td>
<td>15</td>
<td>18</td>
<td>6</td>
</tr>
<tr>
<td>3 – 10 times</td>
<td>15</td>
<td>30</td>
<td>12</td>
<td>2</td>
</tr>
<tr>
<td>Above 10 times</td>
<td>12</td>
<td>32</td>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

During 1993-94, 12 per cent of the total issue was subscribed by more than 10 times. The situation got worse in the year 1996-97 with only one per cent of the total issue resulted in subscription of more than 10 times. As many 91 per cent of total issues failed to get sufficient response from the public in 1996-97.

2.3.2.3. Equity at Premium

There was a major decline in equity at premium issues which comprised a meagre 21 per cent of total capital mobilisation in comparison to 43 per cent in 1995-96 and 46 per cent in 1994-95. The number of issues made at premium fell down from 463 in 1994-95 to 302 in 1995-96 and to 87 in 1996-97.
2.3.2.4. Savings of Householders

The savings pattern of household sector in various securities is shown in Table 2.5.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency</td>
<td>15.9</td>
<td>10.6</td>
<td>12.0</td>
<td>8.2</td>
<td>12.2</td>
<td>11.4</td>
<td>13.1</td>
</tr>
<tr>
<td>Bank deposits</td>
<td>29.0</td>
<td>31.8</td>
<td>26.2</td>
<td>36.7</td>
<td>33.2</td>
<td>40.2</td>
<td>28.2</td>
</tr>
<tr>
<td>Non-Bank deposits</td>
<td>3.8</td>
<td>2.2</td>
<td>3.3</td>
<td>7.5</td>
<td>10.6</td>
<td>8.4</td>
<td>13.77</td>
</tr>
<tr>
<td>Share and Bonus</td>
<td>5.5</td>
<td>8.4</td>
<td>10.0</td>
<td>10.2</td>
<td>9.2</td>
<td>6.1</td>
<td>4.7</td>
</tr>
<tr>
<td>UTI and other Mutual Funds</td>
<td>4.5</td>
<td>5.8</td>
<td>13.3</td>
<td>7.0</td>
<td>4.3</td>
<td>2.8</td>
<td>0.2</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The share of savings in shares and debentures which has been steadily increasing since 1989-90 has started showing a downward trend for two consecutive years (1994-95 and 1995-96).

2.3.2.5. Capital mobilised through Debt and Equity

The capital raised through debt and equity from the year 1990-91 to 1995-96 is presented in Table 2.6.
Table 2.6

Capital mobilised through Debt and Equity

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity (Rs. crore)</th>
<th>Debt (Rs. crore)</th>
<th>Equity (% share)</th>
<th>Debt (% share)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>3964.27</td>
<td>7224.09</td>
<td>35.43</td>
<td>64.57</td>
</tr>
<tr>
<td>1991-92</td>
<td>5669.00</td>
<td>8738.08</td>
<td>39.35</td>
<td>60.65</td>
</tr>
<tr>
<td>1992-93</td>
<td>18124.14</td>
<td>10919.94</td>
<td>62.40</td>
<td>37.60</td>
</tr>
<tr>
<td>1993-94</td>
<td>22974.44</td>
<td>26497.61</td>
<td>58.21</td>
<td>41.79</td>
</tr>
<tr>
<td>1994-95</td>
<td>36019.33</td>
<td>13201.13</td>
<td>73.18</td>
<td>26.81</td>
</tr>
<tr>
<td>1995-96</td>
<td>19647.99</td>
<td>9408.33</td>
<td>67.62</td>
<td>32.38</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

During 1990-91 and 1991-92, equity accounts for 35 and 39 per cent of the total capital raised respectively. This proportion was reversed in 1992-93, the first year of free pricing, when the share of equity increased to 62 per cent. The share of equity finance increased to a high of 73.18 per cent in 1994-95. However, in 1995-96 there is a rise in the importance of debt largely due to the high interest rates in the economy and negative returns from the secondary market.

2.3.2.6. Distribution of Public Issues by Issuer

The distribution of public issues by new companies and existing companies from the year 1990-91 to 1996-97 is presented in Table 2.7.
Table 2.7

Distribution of Public issues by issuer

(Amount in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>New Coys</th>
<th>Existing Coys</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Amount</td>
<td>Number</td>
</tr>
<tr>
<td>1990-91</td>
<td>86</td>
<td>737</td>
<td>278</td>
</tr>
<tr>
<td>1991-92</td>
<td>94</td>
<td>941</td>
<td>420</td>
</tr>
<tr>
<td>1992-93</td>
<td>201</td>
<td>3204</td>
<td>836</td>
</tr>
<tr>
<td>1993-94</td>
<td>2521</td>
<td>5645</td>
<td>887</td>
</tr>
<tr>
<td>1994-95</td>
<td>369</td>
<td>6470</td>
<td>1315</td>
</tr>
<tr>
<td>1995-96</td>
<td>372</td>
<td>1534</td>
<td>1056</td>
</tr>
<tr>
<td>1996-97</td>
<td>209</td>
<td>1260</td>
<td>544</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The percentage of number of issues made by existing companies has decreased from 80 per cent in 1992-93 to 72 per cent in 1996-97. However, the amount raised by these companies has risen from 71 per cent to 89 per cent in the corresponding period.

2.3.2.7. Mutual Funds

During the year 1995-96, four new mutual funds were set up taking the total number of mutual funds in the country to 25. However, there was reverse flow of funds to the mutual funds during the year in view of sluggishness in the capital market. During 1995-96, the total funds raised
by mutual funds aggregated to Rs.5,742 crore. Table 2.8 shows the amounts mobilized by the mutual fund industry in 1996-97 and 1997-98.

**Table 2.8**

*Mobilisation by Mutual Funds*  
(Rs. in crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Public</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>1362</td>
<td>584</td>
<td>1910</td>
</tr>
<tr>
<td>1997-98</td>
<td>4035</td>
<td>419</td>
<td>4454</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The collection through fresh issues by mutual funds stood at Rs.4,454 crore in 1997-98, a rise of 133 per cent over the last year. However, a comparison to the earlier years does not show a favourable trend.

2.3.2.8. Funds Mobilised by Type of Instruments

Table 2.9 shows the break up of the modes of fund mobilization during 1996-97 and 1997-98.
Table 2.9  
Funds Mobilisation through various modes

<table>
<thead>
<tr>
<th>Year</th>
<th>Public</th>
<th>Rights Placement</th>
<th>Private</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>13491</td>
<td>2652</td>
<td>18104</td>
<td>34247</td>
</tr>
<tr>
<td>1997-98</td>
<td>6765</td>
<td>2005</td>
<td>30944</td>
<td>39714</td>
</tr>
<tr>
<td>% change</td>
<td>-49.95</td>
<td>-24.39</td>
<td>71</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The funds mobilised through various routes from the primary market is marginally higher in 1997-98. However, the pattern of financing is drastically altered. The funds mobilised through equity route decreased by 49.85 per cent while the amount of rights by 24.39 per cent. Private placement appears to be the most preferred route of raising funds showing an increase of 77 per cent over the previous year.

2.3.2.9. Issues by Type of instrument

Table 2.10 shows the issue by type of instrument for the years 1996-97 and 1997-98.
Table 2.10
Capital Issues by Instrument Type

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity (Rs. in crores)</th>
<th>Preference Shares</th>
<th>PSO Bonds (Rs. in crores)</th>
<th>Bonds/Debentures (Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>8299</td>
<td>194</td>
<td>12149</td>
<td>3448</td>
</tr>
<tr>
<td>1997-98</td>
<td>3109</td>
<td>632</td>
<td>17056</td>
<td>5416</td>
</tr>
<tr>
<td>% change over</td>
<td>-62.53</td>
<td>225.77</td>
<td>40.39</td>
<td>57.07</td>
</tr>
<tr>
<td>1996-97</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Prime Annual Report.

The total amount of funds raised through equity showed a decline of 62.53 per cent whereas the funds mobilised through bonds and debentures registered an increase of 57.07 per cent. This shows a shift in the preference of investors from equity financing to debt financing.

Table 2.11 shows the capital raised during financial years 1998-99 and 1999-2000. During the financial year 1999-2000, resource mobilization from the primary market recorded an increase of 39.9 per cent from Rs.5,586.49 crore during 1998-99 to Rs.7,816.56 crore during 1999-2000. This has been use of the highest growth rate is capital mobilised during the post-reform period.
Table 2.11
Listed and IPOs issues during April – March 2000

<table>
<thead>
<tr>
<th></th>
<th>1998-99</th>
<th>1999-2000</th>
<th>% of increased in capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Amount</td>
<td>No</td>
</tr>
<tr>
<td>LISTED</td>
<td>40</td>
<td>5182.25</td>
<td>42</td>
</tr>
<tr>
<td>I.P.O.s</td>
<td>18</td>
<td>404.21</td>
<td>51</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td>5586.46</td>
<td>93</td>
</tr>
</tbody>
</table>

Source: SEBI, Banks and Finance, June 2000.

Table 2.12 shows the number of issued made and the capital raised in the I.P.O. market during the month of April 2000. It shows that in April 2000, listed companies floated only 2 issues and raised Rs.404.35 crore while 9 I.P.O.s entered the market but collected only Rs.123.41 crore as compared to 6 issues for Rs.436.17 crore by listed companies and 1 I.P.O. for Rs.3.78 crore in March 1999.
Table 2.12
Listed and IPOs issues during March 1999 – March 2000

<table>
<thead>
<tr>
<th></th>
<th>March 1999</th>
<th>March 2000</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Amount</td>
</tr>
<tr>
<td>LISTED IPOs</td>
<td>6</td>
<td>436.17</td>
</tr>
<tr>
<td>I.P.O.s</td>
<td>1</td>
<td>3.78</td>
</tr>
<tr>
<td>Total</td>
<td>7</td>
<td>439.95</td>
</tr>
</tbody>
</table>

Source: SEBI, Banks and Finance, June 2000.

Table 2.13 shows the capital raised during April – March 2000. The table clearly shows that the market received 51 IPOs for mobilizing Rs.2,719.04 crore during 1999-2000 as compared to 18 issues for mobilizing only 404.21 crore in 1998-99. As a result the share of IPOs in total capital raised from the primary market increased to 34.7 per cent during 1999-2000 from a mere 7.2 per cent in 1998-99. This development, assumes significance that the growth in I.P.O. is recorded in contrast to the continual decline in the equity prices on secondary market.
Table 2.13


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of</td>
<td>Amount</td>
<td>No. of</td>
</tr>
<tr>
<td></td>
<td>issues</td>
<td>%</td>
<td>issues</td>
</tr>
<tr>
<td>LISTED</td>
<td>40</td>
<td>69.0</td>
<td>5182.25</td>
</tr>
<tr>
<td>I.P.O.s</td>
<td>18</td>
<td>31.0</td>
<td>404.21</td>
</tr>
<tr>
<td>Total</td>
<td>58</td>
<td>100</td>
<td>5586.46</td>
</tr>
</tbody>
</table>


The accelerated growth in issue of IPOs and their successful subscription indicates that there is higher level of confidence in IPOs shown by investors. The transparency and disclosure norms introduced by the SEBI have improved the credibility of new issues.

Another factor to be noted is that average size of an I.P.O. was Rs.53.31 crore which is smaller than the average size of Rs.121.33 crore for listed companies during 1999-2000. This is because of a relatively larger number of small size new entrants in the market. Again in terms of percentage share, IPOs accounted for 34.78 per cent during 1999-2000 as compared to share of 7.23 per cent during the same period in 1998-99 which reveals that the new unlisted companies are entering the market in large numbers. The entry of new companies with public issues on an accelerated rate is providing additional instruments for trading in the secondary market.
2.3.3. QUALITATIVE DEVELOPMENTS

A number of qualitative developments also took place in the primary market, particularly after 1985. The India Economy has undergone the remarkable transitions and development following the major economic reforms in June 1991, undertaken by the Government of Narashima Rao through the Finance Minister Dr. Man Mohan Singh and Commerce Minister P. Chidambaram with an objective of making the Indian economy grow fast. Rapid growth is to be achieved through better efficiency of resource use for which competition, both domestic and global, is considered essential.

In this direction, the process of reform of the capital market has been initiated in 1992 along the lines recommended by the Narasimham Committee. It aimed at removing direct government control and replacing it by a regulatory framework based on transparency and disclosure supervised by an independent regulator. The first step is taken in 1992 when the Securities and Exchange Board of India (SEBI), which was originally established as non-statutory body in 1988, is elevated to a fully-fledged capital market regulator with statutory powers. The requirement of prior government permission for accessing capital market and for prior approval of issue pricing has been abolished and companies are allowed to access markets and price issues freely, subject only to disclosure norms laid down by SEBI. At the same time, SEBI has made efforts to see that companies approaching the public for capital, disclose adequate, authentic and accurate information about their past performance and future prospects, so as to enable the investor to arrive at an informed investment decision.
The stock invest scheme has been introduced, to prevent the blocking of investment funds in the primary issues. The minimum application amount has been raised from Rs.1,000 to Rs.5,000 in order to reduce the cost of issue of capital and bring about speedier allotment, while at the same time, gearing up the process of institutionalization of the market. Steps have been taken for observation of equitable norms for the approval and pricing of preferential allotments to promoters, allowing flexibility in pricing by way of fixing a price band. Specialised financial institutions such as merchant bankers, mutual funds, venture capital funds and credit rating agencies have been set up. SEBI initiated various steps for investor protection in the primary market. In this direction the SEBI has put in place a modern regulatory framework with rules and regulations governing the behaviour of major market participants such as stock exchanges, brokers, merchant bankers and mutual funds. It issued a number of guidelines to intermediaries in the primary market in the areas of due diligence, allocation of responsibilities, and observance of post-issue requirements. For this purpose, registration is made compulsory for merchant bankers, underwriters and registrars. It has also sought to regulate activities such as takeovers and insider trading which have implications for investor protection.

The governing structure of stock exchanges has been modified to make the boards of the exchanges more board based and less dominated by brokers. The new regulatory framework seeks to strengthen investor protection by ensuring disclosure and transparency rather than through direct control. SEBI acts as a supervisor of the system undertaking
supervision of the activities of various participants including stock exchanges and mutual funds and violations of the rules are punishable by SEBI. In June 1994, about 450 merchant bankers and over 125 registrars registered with SEBI. By the end of September 1996, the number of merchant bankers registered with the SEBI, has gone upto 1151. Besides, the Unit Trust of India (UTI), there were five mutual funds subsidiaries of public sector banks, two mutual fund subsidiaries of investment institutions (Life Insurance Corporation of India and General Insurance Corporation of India) and seven private sector mutual funds.

2.3.4. SLUGGISH CONDITION OF PRIMARY MARKET

Despite, the improvements in the regulatory framework, tradings and settlement systems, the functioning of new issue market and its components has been the subject matter of much criticism. There is a general perception that the interests of investors, especially small investors have been adversely affected as the freedom given to the issuers and the merchant bankers have been misused. Many unscrupulous companies took advantage of the removal of government control over issue prices to raise capital at inflated prices at the expense of inexperienced investors. Merchant bankers and underwriters involved in these issues are seen to have acted discriminatorily and in favour of issuers firms only, ignoring the interests of investors and misleading the investors. In several cases the projections made and the cases specified for justification of high premium have gone away and wrong. The issues, irrespective of their issue price

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which is as much as high, continue to be quoted well below the offer prices. This happened despite the general buoyancy, in the initial stage of free pricing, in the market. Manipulation of prices in cases of further issues of capital are reported widely. Rigging up of prices in the unofficial market prior to listing have become common occurrences. It resulted in disappointment of not only the newly entered and ill-informed investors in the market but also the investors who invested in a wide range of blue chip stocks or in mutual funds including the funds managed by same of the best known international names. This is because sensex has fluctuated widely since 1993 with a dominantly bearish trend in 1997-98.

2.3.5. REASONS FOR POOR PERFORMANCE IN NEW ISSUE MARKET

There was a fall in the amount raised through New Issue market from March 1995. The New Issue market was dull and insipid in 1997-98. The number of new issues, which were 813 in 1996-97 drastically fell down to 62 issues in 1997-98. It is interesting to note that out of every 100 public issues 39 was over subscribed in 1995-96 but in 1996-97 it was 8. At the same time the 7 out of every 100 companies in 1996-97 had to return application money to investors for failing to raise minimum stipulated amount in capital issue. The reasons for this sordid state of affairs are given below.

2.3.5.1. Scarcity of Floating Securities

To add fuel to the fire, there is scarcity of floating securities in the market. It is due to the fact that institutional investors who collectively own nearly 75 per cent of the equity capital in the private sector, retain
their holdings with themselves without offering them for trading. Availability of shares of such companies to individual investors was increasingly depleted. Hence, the market is highly volatile and it is subject to easy price manipulations.

A study reveals that nearly 75 per cent of the inadequately traded companies have a paid up capital of less than Rs.3 crores and their public holding is poor. Nearly 80 per cent of the thinly-traded companies have public holding of less these companies, there are less than 10,000 shareholders on the registers. The holding of the promoters and financial institutions is so heavy that no public interest exists. Hence trading cannot take place.

To make matters worse, there is inadequate supply of good scrips leading to supply and demand imbalances.

2.3.5.2. Poor Liquidity

Though there are approximately 7800 listed companies in India, the shares of only a few companies are actively traded in the market and they are liquid. It is reported that of the total turnover on the BSE and the NSE, over 60 per cent is concentrated in just 10 stocks. Hence, investors of many companies are on the horns of a dilemma on account of lack of liquidity. A vast majority of the shares are illiquid and hence investors of such companies shares have to burn their hand. For instance, the turnover in Bombay Stock Exchange for Group A and Group B shares has been displayed in the following tables.
Table 2.14

Turnover in Bombay Stock Exchange

<table>
<thead>
<tr>
<th>Year</th>
<th>A Group (Rs. in crores)</th>
<th>B Group (Rs. in crores)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>28,610</td>
<td>56,527</td>
</tr>
<tr>
<td>1996</td>
<td>83,347</td>
<td>10,726</td>
</tr>
</tbody>
</table>

Source: SEBI Bank and Finance.

The above table clearly points but a substantial reduction in the volume of trading of B group shares. It shows a lack of liquidity for majority of shares. Another study recently points out that shares of 207 companies were traded every day; shares of 538 companies were traded once a week; shares of 396 companies were traded once a fortnight; shares of 954 companies were traded once a month; and shares of 959 companies were traded once a year. It clearly shows that the Indian stock market is suffering from poor liquidity. Another study points out that out of 8000 and odd companies listed hardly 400 to 600 companies are well traded. It means that in nearly 90 per cent of the companies, there is no liquidity as the market is not developed in them. It showed that the market was very weak since the liquidity which is the prerequisite for high market efficiency was mostly absent.

2.3.5.3. Unhealthy Competition of Merchant Bankers

At present there are about 900 merchant bankers rendering their services in the capital market. The increase in the number of merchant bankers has led to unhealthy competition and dilution of the quality of
issues. Merchant bankers tend to show a definite bias towards the issuing company instead of protecting the interest of investors. They help the unscrupulous promoters to raise funds for dubious projects at unjustifiable premium. The ultimate sufferers are the investors.

2.3.5.4. Poor Disclosure of Financial Information

The efficiency of capital market depends upon the availability of reliable and complete information about the issues and companies. The prospectus issued by many a company does not contain adequate and relevant information to enable investors to take correct investment decisions. Sometimes, the information given is misleading and deceptive. Further, the brochures and pamphlets and advertisements issued at the time of public issue tend to present a biased profile of the company.

2.3.5.5. Manipulations of Security Prices

Companies using securities, often, artificially push up the prices before the issue of securities. This process starts well before a company seeks permission from the government for the issue of further capital. Not only is an attempt to get a higher premium on the basis of prices so manipulated being made but also attempts at manipulating prices continue thereafter to lure investors to subscribe to these further issues.

In the name of stabilization, financial institutions and mutual funds appeared to become to market manipulation and appeared to conduct 'salvage' operations for the speculators. There is no seriousness to check performance of the company after the issue.
2.3.5.6. Prevalence of Insider Trading

Insider trading has been accepted as a routine practice in India. Insiders are those who have access to unpublished price-sensitive information by virtue of their position in the company and who use such information in their best advantage. Since it is an undesirable activity, the SEBI has introduced many regulations to curb insider trading. All of them remain in paper only and it is said that controlling insider trading is similar to controlling black money.

2.3.5.7. Presence of Price-Rigging

There is a tendency among companies using securities to artificially push up the prices before the issue of securities. This is generally done by buying and selling securities by a few group of persons among themselves and thereby pushing the prices up. There is a strong bull movement in the market:

2.3.5.8. High Volatility of Stock Market

The Indian Stock Market is subject to high volatility in recent years. The All India Index number of security prices was steady at 25 per cent between the period 1980 and 1989. However, it was subject to heavy fluctuations afterwards. For instance the rate of fluctuation in the security prices was 56.2 per cent in 1990-91, 55.9 per cent in 1991-92, 67.4 per cent in 1992-93, 50.9 per cent in 1993-94 and 55.6 per cent in 1994-95. At the same time, the global average annual rate was ranging between 28.6 per cent and 32.9 per cent during the same period. This high rate of volatility is not conducive for the smooth functioning of the stock market.
2.3.5.9. Cumbersome Procedures of Settlement

Trade transactions have to be settled by physical delivery of securities accompanied by transfer deeds. It means that securities have to move from the seller to the seller's broker and from the buyer's broker to the buyer. It makes the settlement dilatory. Again the buyer has to lodge the securities for transfer. This process takes two or three months. The irksome settlement procedures result in frequent delays in payment for shares as well. The rolling settlement system (where each day constitutes an accounting period and its trades are settled after a few days say 3 or 4 or 7) is conspicuously absent except in OTC Exchange.

2.3.5.10. Problem of Odd Lots

Generally, the listed securities are included under Group A or Group B categories as stated earlier. The other tradable securities which are not listed are called 'Odd Lots' and they came under the category of Group C. This group also contains permitted securities which are listed on other exchanges and not on the particular stock exchange concerned.

Investors in India have to face the problem of odd lots. Generally, as per the existing practice, all sales of odd lots are subject to discounts varying upto 15 per cent and all purchases are subject to a premia of 15 per cent of even more. It means that the investor is a tremendous loser. It discourages investments on odd lots and thereby limiting the trading activities of odd lots.
2.3.5.11. Dominance of Public Sector

In recent years, the investors have lost faith in the private sector. Hence, the private sector has been having little success in equity mobilisation. According to Prime, the premier data base on the primary capital market, the equity mobilization of the private sector was Rs.12,061 crores in 1994-95. It has reduced to Rs.6,663 crores in 1995-96 and to only Rs.2,919 crores in 1996-97. Another study reveals that out of 653 issues floated in 1996-97, only 8 per cent of the issue (62 issues) has been oversubscribed. On the other hand, the public sector’s share has been Rs.3,971 crores (29 per cent) during 1995-97 (two year period) and it is expected to rise to over 50 per cent in 1997-98.

On the debt front, of the total Rs.9,817 crores mobilised through debt public issues in the 1995-97 period, the public sector accounted for a significant 87 per cent at Rs.8,627 crores. The investor’s loss of faith in the private sector is not a healthy trend. Against, the preponderance of debt instruments has affected the active trading in equities. Generally, there is no active secondary market for debt instruments.

2.4. CAPITAL MARKET – MODERN SYSTEMS AND PRACTICES

2.4.1. THE TRADING SYSTEM

In March 1995, the Bombay (Mumbai) Stock Exchange has introduced screen based trading called BOLT (BSE on-line trading). The BOLT is designed to get best bids and offers from jobbers’ book as well as the best buy and sell orders from the order book. Now the BOLT has a nation wide network. Trading Work Stations are connected with the main
computer at Mumbai through Wide Area Network (WAN). The capacity of the Tandem hardware of BOLT is 5,00,000 trades per day (in 6 hours i.e. from 9.0 a.m. to 3.30 p.m.). After getting specific approval from SEBI, BOLT connections have been installed in Ahmedabad, Rajkot, Pune, Vadodara and Calcutta. The number of scrips on BSE was 4,702 in March 1995 and has increased to 5,853 in March 1998.

The securities traded in the BSE are classified into three groups namely, specified shares or ‘A’ group and non-specified securities. The latter is sub-divided into ‘B1’ and ‘B’ groups. ‘A’ group contains the companies with large outstanding shares, good track record and large volume of business in the secondary market. Carry forward transactions for a period of 90 days are permitted in ‘A’ group shares. ‘A’ group contains 150 companies. Relatively liquid securities come under the ‘B1’ group and it comprises 746 companies. The remaining shares are placed under the ‘B’ group. Settlements of all the share are carried out through the Clearing House. The settlement period is reduced from 14 days to 7 days for all scrips.

2.4.2. MARGINS

The trading members deposit part of their trades as a margin to the exchange. The margin amount varies for Type-I members who trade in ‘A’ group shares and Type-II members who have not opted for carry forward trade. Type-II members pay a daily margin of 15 per cent on their trades both on delivery and carry forward for Type-II members, the margin is computed on the basis of gross exposure or net exposure and the higher of the margin is charged. Mark-to-market margins are collected on
all notional losses on a daily basis. Carry over margin is collected when traders’ transactions are carried forwarded in ‘A’ or specified group scrip from one settlement to another settlement.

2.4.3. NATIONAL STOCK EXCHANGE OF INDIA

The high-powered committee on the establishment of new stock exchanges headed by M.J.Pherwani, the former UTI Chairman, first mooted the idea of a National Stock Exchange in June 1991. NSE is a country-wide, screen based, on-line trading bourse with an order–driven trading system. NSE is committed to usher in a settlement period of T + 1 i.e., delivery of shares and payment of price to be effected on the day following the day of trade.

The National Stock Exchange of India was incorporated in November 1992 with an equity capital of Rs.25 crore and promoted by IDBI, ICICI, LIC, GIC and its subsidiaries, State Bank of India and SBI Capital Markets Limited.

The NSE establishes nation-wide trading facility for equities, debts and hybrids; facilitates equal access to investors across the country; provides fairness, efficiency and transparency to the securities trading; enables shorter settlement cycles; and meets international securities market standard.

The establishment of National Stock Exchange (NSE) is a step to overcome the deficiencies of the existing stock market and to bring Indian financial markets in line with international markets.
NSE has two segments: the capital market segment and whole sale debt market segment.

The capital market segment covers equities, convertible debentures and retail trade in debt instruments like non-convertible debentures. Securities of medium and large companies with nationwide investor base, including securities traded on other stock exchange are traded in NSE through trading members.

The companies with the minimum paid up capital of Rs.10 crores are listed in NSE. The software in the NSE trading system is known as National Exchange for Automated Trading (NEAT). The trade takes place through computers.

The Trading members' computers are connected with the central computer at NSE through leased lines and VSAT (Very Small Aperture terminals) which are small dish antenna. Communication is carried out with the help of the satellites. Network management centre is related to network throughout the day. This helps the traders to carry out their activities with minimum interruption.
Comparison Between Stock Exchange, OTCEI and NSE

<table>
<thead>
<tr>
<th></th>
<th>Stock Exchange</th>
<th>OTCEI</th>
<th>NSE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Membership</td>
<td>Individuals, Corporates only</td>
<td>Individuals, Corporates only</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Individuals, Firms &amp; Corporates</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Method of trading</td>
<td>Floor based</td>
<td>Screen based</td>
</tr>
<tr>
<td>3</td>
<td>System of Trading</td>
<td>Quote-driven, Manual</td>
<td>Code driven</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Computers linked to central OTCIE through telephone lines</td>
</tr>
<tr>
<td>4</td>
<td>Settlement</td>
<td>T + 14</td>
<td>T+3 rolling settlement</td>
</tr>
<tr>
<td>5</td>
<td>Transparency</td>
<td>Nil</td>
<td>Ensured</td>
</tr>
<tr>
<td>6</td>
<td>Intermediary</td>
<td>Jobber needed</td>
<td>Not needed</td>
</tr>
</tbody>
</table>
### Operation of National Stock Exchange

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover (cr)</td>
<td>1,850</td>
<td>67,287</td>
<td>2,94,504</td>
</tr>
<tr>
<td>No. of listed companies</td>
<td>135</td>
<td>422</td>
<td>550</td>
</tr>
<tr>
<td>Market capitalisation (cr)</td>
<td>75,223</td>
<td>2,17,721</td>
<td>2,52,894</td>
</tr>
<tr>
<td>Permitted Equities</td>
<td>543</td>
<td>846</td>
<td>932</td>
</tr>
</tbody>
</table>

Of the total trading turnover of Rs.9,08,691 crores by the 22 stock exchanges in 1997-98 the trading turnover of NSE was the highest at Rs.3,69,934 crores and accounted for about 41 per cent of the total trading volume.

2.4.4. OVER THE COUNTER EXCHANGE OF INDIA

Over the Counter Exchange of India was started in 1992 after the role models of NASDAQ (National Association of Securities Dealers Automated Quotation) and JASDAQ (Japanese Association of Securities Dealers Automated Quotation). The OTCEI was started with the objective of providing a market for the smaller companies that could not afford the listing fees of the large exchanges and did not fulfill the minimum capital requirements for listing. It aimed at creating a fully decentralised and transparent market. Over the counter means trading across the counter in scrips. The counter refers to the location of the member or dealer of the OTCEI where the deal or trade takes place. Every counter is treated as a trading floor for the OTCEI where the investor can buy and sell. The
members or dealers of OTCEI counters are linked to the central OTCEI computer. The member should have the computer and telecommunication facility. OTCEI is incorporated as a company under sec. 25 of the Indian Companies Act 1956. As per the registration norms, OTCEI will be obliged to plough back all its profits and will not be allowed to declare dividends on its share capital.

Guidelines are issued for the companies whose scrips have to be traded in the OTCEI by the Government. As per the guidelines; the minimum capital requirements for a company to be listed on the OTCEI is Rs.3 crores and the maximum is Rs.50 crores. For companies with an issued of more than Rs.30 lakhs but less than 300 lakhs, the minimum public offer should be 25 per cent of the issued capital or 20 lakhs worth of shares in face value, whichever is higher. Companies with an issued capital of more than Rs.30 crore seeking to be listed have to comply with listing requirements and guidelines that are applicable to such companies in other stock exchanges. To broaden the base of exchange membership the guidelines have been revised. The ministry allowed closely held existing corporate houses upto 100 crores. New Companies with a paid up base of upto 50 crore and all currently listed companies on various stock exchanges. OTCEI was established with the purpose of providing a fair trade platform for the shares of the small cap companies. But later for the survival, companies with medium and large capital base are permitted to trade the OTCEI.
2.4.5. CLEARING AND SETTLEMENT

The clearing and settlement operations of the exchange are managed by its wholly owned subsidiary, the National Securities Clearing Corporation Ltd. (NSCCL). The exchange provides facility for multiple settlement mechanisms including account period settlement in regular market, sub-segment dealing in physical securities and rolling settlement-Normal (Lot size one) and rolling settlement-Normal (Marketable lots) in book entry sub-segment.

The account period cycle starts every Wednesday. It ends on a Tuesday with the pay-in of securities on the next Monday, pay-in of funds on the next Tuesday and pay out-of funds and securities on the next Wednesday. The settlement in the book entry sub-segment is completed within 8 days of last day of the trading cycle. The rolling settlement is on T+5 working day basis i.e. typically trades taking place on Monday will be settled on the next Monday. Tuesday’s trades will be settled on the next Tuesday and so on. All settlements for securities are through the clearing house in the case of physical settlement and through the depository in the case of book entry sub-segment.

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Deals on the book entry sub-segment are settled through the depository. The NSCCL works together with the depository on one hand, and the clearing banks on the other to provide Delivery Versus Payment (DVP) settlement for depository enabled trades.

2.4.6. SETTLEMENT SYSTEM

At present the settlement procedure has five days trading cycle. Forward trading is not permitted on OTCEI. Short sales and squaring up have to be done within the trading cycle and certificate to the investors must be delivered within a fortnight from the date of purchase. Thus, it avoids speculation. The settlement procedures are different for the listed securities and the permitted securities.

In the listed securities once the deal is struck, temporary or permanent counter receipts as applicable is issued to the investor in the case of purchase or sale and confirmation slip in the case of sale by investor. The settlement agent verifies the signatures on the PCR and shall store and match the transfer deeds. The CR alongwith transfer deed is sent to the registrar for the transfer. The transfer of shares takes place within seven days. The requests for transfers are closed seven days before the date of book closure or record date which ever is applicable.
2.4.7. NATIONAL SECURITIES DEPOSITORY LIMITED

NSDL is an organisation promoted by the Industrial Development Bank of India, the Unit Trust of India and the National Stock Exchange of India Ltd., to provide electronic depository facilities for securities traded in the equity and the debt market. The depositories’ ordinances promulgated by the Government of India in September 1995 enabled the setting up of multiple depository system. The Securities and Exchange Board of India (SEBI) issued the guidelines for depositories in May 1996. The Bill was passed by the parliament in July 1996. NSDL was registered by SEBI on June 7, 1996, NSDL performs different functions:

It enables surrender and withdrawal of securities to and from the depository; maintains investors holdings in the electronic form; effects settlement of securities traded on exchanges and carries out settlements of trade that have not been done on the stock exchanges. NSDL (DP) Depository Participant can be a public financial institution, bank, custodian, registered stock broker or a NBFC subject to approval from the depository company and the SEBI. Brokers and NBFCs are required to have a minimum networth of Rs.50 lakhs. DP has to pay a security deposit of Rs.10 lakhs and an admission fee of Rs.25,000 to NSDL. The depository participants are likely to pass on these charges to the investors. NSDL operates on two tier structures wherein it maintains accounts of its DP and the DP’s maintain the accounts of their clients. With the help of the continuous electronic connectivity, reconciliation of all accounts is done on daily basis to balance the number of stocks issued and dematerialized. Initially, NSDL makes use of VSAT network of the NSE for communications as it is easier for the depository participants who have
leased lines with NSE to join. After ascertaining its requirements on the volume of trade, NSDL would set up its own network. The SEBI has now made it mandatory for all stock exchanges to have clearing corporation. The stock exchanges are setting up their own clearing corporation.

2.4.8. INDIVIDUAL INVESTOR AND NSDL

The investor has open an account with the depository participant that is similar to the opening of a bank account. Investors can get a list of depository participant from NSDL. The depository participants may also advertise the services offered by them once they are registered. The investor can choose any depository participant of his choice and fill up an account opening form. Reasonable charges are received by the depositories for the opening of accounts and every transaction in the accounts. The investor receives a pass book or a statement of holdings, just like the bank passbook from the depository agent. The statement of holdings is dispatched to the investors periodically. The investor can contact the depository participant for any disparity in the statement of holding. If the discrepancy cannot be resolved at the depository participant level, he could approach NSDL for clarification. There is absolutely no restriction with the number of depository participants the investor can open accounts.

2.4.9. DEMATERIALISATION

Dematerialisation is a process in which the physical certificates of an investor are taken back by the company. The registrar destroys the shares and equivalent number of shares are credited in the electronic
holdings of the investor. This is done at the request of the investor. The process involved is as follows:

Surrendering of certificate to Depository participants for dematerialisation; NSDL is informed by the DP through electronic conductivity; original share certificates are submitted to the registrar by the DP; the request for dematerialisation from NSDL to the registrar; the registrar credits an equivalent number of shares in the account and informs NSDL; the NSDL updates its own account and the depository participants are informed. The depository agent credit it in the account of the investor of the investor and the same is informed to the investor.

2.4.10. REMATERIALISATION

Sometimes the investor may like to convert his electronic holdings back into physical share certificate. The process undertaken for this purpose is called rematerialisation. The investor has to make a request to the depository participant for rematerialisation. The depository participants puts forward the request to NSDL after verifying the investor is having necessary security balances. NSDL in turn will intimate the registrar who prints the certificate and dispatch the same to the investor. The certificate has a new range of certificate numbers and new folio number.

In this process, investor request the DP for rematerialisation; the depository participants informs it to the NSDL; NSDL intimates the Registrar; the Registrar of the company prints certificates with new
numbers and informs NSDL; NSDL adjusts its account and passes on the details to the DP; the certificates are dispatched to the investor.

There are about 87 depository participants in April 1999, forty two of these are banks. The depository participants offer services for dematerialisation at 830 locations across the country. The entire universe of stocks in S & PCNX Nifty, Sensex index and 90 per cent of the stock in stocks in S & P Nifty Junior and BSE forward list are in the demat mode. Nine stock exchanges are connected with NSDL and offer trade and settlement in demat mode. They are NSE, BSE, OTCEI, ISE, Stock exchanges at Chennai, Bangalore, Calcutta, Delhi and Ludhana. The biggest task before the NSDL today is winning over the common investor. Small investors prefer to hold physical shares rather than mere passbooks with entries of stocks. Even in advanced US market where paperless trading is the order of the day, about 13 per cent of the transactions on the New York Stock Exchange is through the paper based system.

The major hurdle that prevents the common investor to the depository mode is the custodial and transaction charges. The cumulation of all the charges are either be only marginally lower or sometimes even exceed the costs of trading on the paper based system. Since the custodial charges are linked to the market price, the retail investor would be at a disadvantage in a rising market and the depository in the falling market.

2.4.11. SEBI in Investor Protection

Investor protection is the major responsibility of the SEBI. SEBI has taken various measures to protect the interests of investors in new issue market.
The issuing company should provide fair and correct information. Allotment process should be transparent and not tainted by any bias. The draft prospectus of the companies is scrutinised for full and fair disclosure. No delay in refunds or dispatch of share certificates. Underwriting obligations is necessary to inspire confidence of investors. Risk factors and highlights should be fairly stated without any bias in the prospectus. Listing should be timely and transferability is ensured. Both stock exchange and companies are responsible for investor protection in respect of free trading and transferability of shares. The investor protection is to be ensured by not only the company but by all the parties in the new issue process namely merchant bankers, Registrars, collecting banks, stock exchange and SEBI. Recently SEBI has instituted the system of appointing its representatives to supervise the allotment process to ensure that no malpractices take place in allotment process.

For ensuring investor interest protected, SEBI issues guidelines from come time to time considering the problems and issues that arise both in the New Issue Market and in the Stock exchanges. To state a case SEBI imposes penalty upto Rs.5,00,000/- lakhs for those who indulged in insider trading. It also issues few investigators guidance, advertisement and published a book on investor grievances-rights and remedies. SEBI also registered certain active investor’s association. It issued an advertisement code for the issuers to ensure that the advertisement are fair and do not contains statements to mislead the investors. It has set up an investor grievances to handle investor complaints in consultants in RBI and banks, SEBI introduced newly a stock investments him in which the
individuals can make arrangements with their banks for payment of application money while making an application for shares, without actually transferring the amount to the company until shares are allotted to him. The investor has to part with his funds and his account his defeated only when he is eligible to get allotment of shares. Till sustain the fund remains in his account and continues to earn interest, which is normally four months.

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SEBI has issued a few investors guidance, advertisements and published a book on ‘Investor Grievances – Rights and Remedies’. SEBI has also registered certain active Investor’s Association. SEBI has issued
an Advertisement Code for the issuers to ensure that the advertisements are fair and do not contain statements to mislead the investors or vitiate their informed judgement.

Stock invest scheme was designed by the SEBI in consultation with RBI and banks as an additional facility for making applications for new issues. The stock invest is a facility by which individuals can approach the bank with whom they maintain an account for issue of stock invest of required denominations for payment of application money while making an application for shares. The stock invest scheme envisages that the investors account gets debited only on the allotment of shares. The investor, therefore, has to part with his funds only when he is eligible to get allotment of shares. Till such time, the investor’s fund remains in his account and continues to earn interest, which is normally four months.