Chapter-6

Organisation, Membership And Trading Mechanism in the Stock Exchanges

6.1 Organisation

The stock market in India is regulated under the Securities Contracts (Regulation) Act, 1956. There were 19 stock exchanges upto 1990, recognised by Government of India under the Act. The permanent recognition had been granted to 8 stock exchanges i.e. Bombay, Hyderabad, Calcutta, Delhi, Madras, Ahmedabad, Indore and Bangalore. The Bombay Exchange was granted permanent recognition at the first instance. The temporary recognition is granted to other stock exchanges for a period of 5 years with a renewal clause. The organisation of these recognised stock exchanges is reflected in the Table 6.1.

The stock exchanges in India are constituted in the form of limited companies, Companies Limited by guarantee and as association of individuals. The recognised stock exchanges at Bombay, Ahmedabad and Indore are voluntary non-profit making associations, while the Calcutta, Delhi, Bangalore, Cochin, Uttar Pradesh, Ludhiana, Jaipur, Guwahati and Kanara stock exchanges are joint stock companies limited by shares and the Madras, Hyderabad, Patna, Bhubneshwar, Saurashtra, Kutch and Pune Stock exchanges are companies limited by guarantee.
<table>
<thead>
<tr>
<th>Name</th>
<th>Year of Establishment</th>
<th>Type of Association</th>
<th>Original Date</th>
<th>Recognition Period</th>
<th>Permanent Date</th>
<th>Entrance Fee/Par Value of Share (₹.)</th>
<th>Membership Security Deposits (₹.)</th>
<th>Annual Subscription</th>
<th>No. of Members</th>
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<tbody>
<tr>
<td>Bombay</td>
<td>1875</td>
<td>Voluntary Non-Profit Making Association of Persons.</td>
<td>31.8.1957</td>
<td>Permanent</td>
<td></td>
<td>-</td>
<td>2,00,000</td>
<td>5,000</td>
<td>555</td>
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<tr>
<td>Calcutta</td>
<td>1908</td>
<td>Public Ltd. Co.</td>
<td>10.10.1957</td>
<td>5 yrs.</td>
<td>14.4.1980</td>
<td>5,000</td>
<td>2,00,000</td>
<td>3,000</td>
<td>650</td>
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<tr>
<td>Madras</td>
<td>1937 (Recognised 29.4.1957)</td>
<td>Company Ltd. by Guarantee.</td>
<td>15.10.1957</td>
<td>5 yrs.</td>
<td>15.10.1982</td>
<td>25,000</td>
<td>50,000</td>
<td>2,000</td>
<td>168</td>
</tr>
<tr>
<td>Ahmedabad</td>
<td>1894</td>
<td>Voluntary Non-Profit Making Association of Persons.</td>
<td>16.9.1957</td>
<td>5 yrs.</td>
<td>16.9.1982</td>
<td>-</td>
<td>75,000</td>
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<td>Delhi</td>
<td>1947</td>
<td>Public Ltd. Co.</td>
<td>9.12.1957</td>
<td>5 yrs.</td>
<td>9.12.1982</td>
<td>4,000</td>
<td>1,00,000</td>
<td>3,000</td>
<td>124</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>1943</td>
<td>Company Ltd. by Guarantee.</td>
<td>29.9.1958</td>
<td>5 yrs.</td>
<td>29.9.1983</td>
<td>25,000</td>
<td>50,000</td>
<td>2,000</td>
<td>85</td>
</tr>
<tr>
<td>Bangalore</td>
<td>1957</td>
<td>Incorporated as 16.2.1963 a Pvt. Ltd. Co. &amp; converted into a Public Ltd. Co. on 3.4.1962.</td>
<td>16.2.1983</td>
<td>5 Yrs</td>
<td>16.2.1983</td>
<td>1,000</td>
<td>50,000</td>
<td>2,000</td>
<td>123</td>
</tr>
<tr>
<td>Cochin</td>
<td>1978</td>
<td>Public Ltd. Co.</td>
<td>10.5.1979</td>
<td>5 Yrs.</td>
<td></td>
<td>5,000</td>
<td>1,00,000</td>
<td>2,040</td>
<td>476</td>
</tr>
<tr>
<td>Kanpur (U.P.)</td>
<td>1982</td>
<td>-do-</td>
<td>3.6.1982</td>
<td>5 yrs.</td>
<td></td>
<td>1,01,000</td>
<td>10,000</td>
<td>2,000</td>
<td>455</td>
</tr>
<tr>
<td>Pune</td>
<td>1982</td>
<td>Company Ltd. by guarantee.</td>
<td>2.9.1982</td>
<td>5 yrs.</td>
<td></td>
<td>2,500</td>
<td>20,000*</td>
<td>2,000</td>
<td>69</td>
</tr>
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Contd...
Table 6.1 (Contd.)

<table>
<thead>
<tr>
<th>Location</th>
<th>Year</th>
<th>Company</th>
<th>Date</th>
<th>Term</th>
<th>Amount (Rs)</th>
<th>Value (Rs)</th>
<th>Shares (Rs)</th>
<th>Amount (Rs)</th>
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</thead>
<tbody>
<tr>
<td>Ludhiana</td>
<td>1983</td>
<td>Public Ltd. Co.</td>
<td>29.4.1983</td>
<td>5 yrs.</td>
<td>-</td>
<td>10,000</td>
<td>1,50,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Guwahati</td>
<td>1984</td>
<td>-do-</td>
<td>1.5.1984</td>
<td>5 yrs.</td>
<td>-</td>
<td>5,000</td>
<td>50,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Kanara</td>
<td>1985</td>
<td>-do-</td>
<td>9.9.1985</td>
<td>5 yrs.</td>
<td>-</td>
<td>250</td>
<td>50,000</td>
<td>1,000</td>
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<tr>
<td>Magadh</td>
<td>1986</td>
<td>Company Ltd.</td>
<td>11.12.1986</td>
<td>5 yrs.</td>
<td>-</td>
<td>5,000</td>
<td>50,000</td>
<td>3,000</td>
</tr>
<tr>
<td>(Patna)</td>
<td></td>
<td>by Guarantee.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jaipur</td>
<td>1983-84</td>
<td>Public Ltd. Co.</td>
<td>9.1.1989</td>
<td>1 yr.</td>
<td>-</td>
<td>2,500</td>
<td>50,000</td>
<td>2,000</td>
</tr>
<tr>
<td>Bhubanesh-9 war.</td>
<td>Company Ltd.</td>
<td>5.6.1989</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>50,000</td>
<td>2,000</td>
<td>21</td>
</tr>
<tr>
<td>Saurashtra</td>
<td>1989</td>
<td>-do-</td>
<td>10.7.1989</td>
<td>3 yrs.</td>
<td>-</td>
<td>10,000</td>
<td>50,000</td>
<td>2,000</td>
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<tr>
<td>Kutch</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vadodara</td>
<td>1990</td>
<td>N.A.</td>
<td>5.1.1990</td>
<td>5 yrs.</td>
<td>-</td>
<td>N.A.</td>
<td>N.A.</td>
<td>N.A.</td>
</tr>
<tr>
<td>(Baroda)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

© Renewed after every 5 yrs. till grant of permanent recognition.

* Cash deposits as security and Rs.50,000 Bank guarantee or shares of the market value of Rs.75,000 of reputed listed company + membership security deposit for cash share participation is Rs.1,10,000 and Rs.1,65,000 for hand delivery participation.

N.A. - Not Available.

An association of persons form of organisation suits to the members as they can frame rules, bye-laws and regulations which suit them. This was relevant in the initial stages when the investment habits were limited. A stock exchange which is incorporated under Companies Act, 1956 derive powers from the Memorandum of Association and Articles of Association. In a limited company, the liability of the members and stock exchanges is limited. This is the most popular form of organisation in India. In case of stock exchange limited by guarantee, there is no share capital, the liability of the members is limited to the extent of guarantee and numbers of members can be easily increased.

The analysis of existing forms of organisation of stock exchanges in India revealed that most of the stock exchanges have been incorporated under the Companies Act, 1956 in comparison to other forms of organisation i.e. 'Association of Persons' and company limited by Guarantee.

The Governing Body of the Stock Exchanges has wide Governmental and Administrative Powers. It regulates, supervise, direct and control all matters and activities effecting the working of Stock Exchange.

There is no uniformity in the structure of Governing Body. The number of members varies from exchange to exchange and is fixed by the rules and regulations and bye-laws of the exchange. The representation is also not balanced which may lead to biased decisions.
The overall administration of Stock Exchanges is looked after by the Stock Exchange Division of Department of Economic Affairs, Ministry of Finance. Recently, the Government of India has set up an apex body i.e. Securities and Exchange Board of India (SEBI) to promote the healthy and orderly development of security market. The primary task of SEBI is to prepare a comprehensive legislation for the development and regulation of security market. The SEBI has started publishing various pamphlets which are relevant to educate the investors in the security market.

In order to bring the uniformity in the organisation of stock exchanges, a uniform model of organisation is must. The comparison of pros and cons of different forms of organisation revealed that the Companies limited by shares were the most pervasive form of organisation. The present infrastructure for the development of industries and setting up of various form of companies also supported this form of organisation.

6.2 Membership

6.2.1 Eligibility Criteria for Membership

The membership of stock exchanges is regulated through the provisions of the Securities Contracts (Regulation) Rules, 1957. These statutory rules provide that no person shall be eligible to be elected as a member if he is less than 21 years of age; or is not a citizen of India; or has been adjudged as
bankrupt or proved to be insolvent or has compounded with his creditors; or has been convicted of an offence involving fraud or dishonesty; or is engaged as principal or employee in any business other than that of securities; or is a member of any other association in India, where dealings in securities are carried on; or is a director, partner or employee of any company whose principal business is that of dealing in securities. Upto 1990, the total membership in 19 stock exchanges was 4380.

A partnership firm or company was not eligible for membership of a recognised stock exchange. New steps are being taken to enlist Financial Institutions and Corporate Bodies as members of a recognised stock exchanges which would ensure professionalisation of stock broking and better services to the investors. Recently, two companies has became member of a stock exchange.

6.2.2 Educational and Professional Qualifications

Earlier, there were no stipulation of educational qualification for becoming a member of stock exchanges. Even, the Securities Contract (Regulation) Rules, 1957, do not stipulate any educational qualifications for any persons to be eligible for membership of a stock exchange. Due to trading nature and business practices, the more importance was attached to the experience than educational qualifications. Upto 1978, there was no minimum educational qualification prescribed for becoming a member of stock exchange. Thereafter, minimum standard for becoming a member was prescribed matriculation or equivalent examination. 
The rules provide that no person though eligible for admission as a member to a stock exchange shall be admitted unless:

(i) he had at least 2 years market experience as an apprentice or as a partner or authorised assistant or authorised clerks or remiser of a member or;

(ii) he agrees to work for a minimum two years as a partner, or representative member with another member and to enter into bargains on the floor of stock exchange on the name of such other member; and

(iii) he succeeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is in the opinion of the Governing body, a close relation.

Thus, a person who has attained the age of 21 years is eligible for the membership provided he satisfy the criteria pertaining to experience, qualifications etc. But, keeping in view of the rapid changes that are emerging in the Security Market in India, the eligibility criteria as well as educational and professional qualifications need to be improved. There is a need to raise minimum standard of education and professional qualification along with sufficient training and experience in the line.
6.2.3 Problems related to Membership

The various problems concerning membership to stock exchanges have been observed as under:

(a) The general provision for admission to membership to a Stock exchange are cumbersome. With the improvement in educational and professional qualifications etc. the rules relating to a election of a member also need to be suitably amended.

(b) The members of the stock exchanges have rights of nomination which are personal and non-transferable. A right of nomination is subject to the qualification that the candidate for admission must be a member of not less than five to seven years standing. In case of lesser duration he can only nominate his son for admission in his place, provided he is otherwise eligible and the Governing Body has no objection. The right of nomination in some cases has been restricted to the members of the same family. Such a Hereditary system is not in tune with the requirements of the growth of stock exchange. Therefore, nomination system must be improved and norms need to be relaxed and controlled. Taking into account the imperative need to professionalise the membership of the stock exchanges some modifications in the existing system of hereditary membership are essential.

(c) Most of the members are inactive in the stock exchanges. At the end of 1983, the total number of members on
the all stock exchanges was 2174 out of which 848 members were inactive. In some of the stock exchanges like Calcutta, Ahmedabad and Indore, more than 60 percent members were inactive. At present, around fifty percent members are inactive. Such inactive members should not be allowed to retain their membership. There is need to encourage the active members and rules and regulations should be framed to discourage the inactive members.

(d) Highly qualified and professionalised people are not encouraged to become the members of the stock exchanges. Keeping in view of multifarious functions of stock exchanges, the qualifications of the members be improved.

(e) The proper infrastructure facilities to the members like office accommodation and office equipments, communication facilities, adequate number of staff, facilities for research analysis and interpretation of financial data have also effected the activities of members. Due to lack of inadequate facilities the members can not be expected to perform their duties in an efficient way. Therefore, adequate infrastructure facilities to the members will lead to proper growth of business amongst the stock exchanges.

(f) Due to lack of inadequate financial strength and solvency of some stockbrokers the confidence of the investors in the functioning of stock exchanges has
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lessened. The unsound financial health also reflect the poor services to the investors. So, there is need to judge the financial soundness of the members before he is granted membership to the stock exchange. There is also need to bring uniformity in the security deposit in all the stock exchanges.

(g) The most of the stock brokers in the country concentrate too much on trading in their own account which leads to conflicts of interest. There is need to bring suitable modifications to avoid trading in own account by the stock-brokers.

(h) It has also been observed that there is significant variation in the entrance fee, membership security deposit and annual subscriptions in the stock exchanges of the country. There is need to bring uniformity and adopt slab system in determining the par value of share, security deposits and annual subscriptions which will enhance membership base in the security market.

6.2.4 Brokers, Sub-brokers and Licenced Dealers

In India, the stock exchange Rules, Bye-Laws and Regulations do not prescribe and functional distinction between members. The members of the stock exchanges act as a brokers or dealers. The brokers, buy and sell the securities for others on a commission basis whereas dealers act as principal,
buying and selling securities on their account for a profit or loss. In Bombay stock exchange, there is fairly a well established specialisation like the commission broker, a jober, the taravaniwalas, the dealer in non-cleared securities, the lot dealer, the budliwala, the arbitrageur and the security dealer.

A growing class of sub-brokers have come into existence which solicit business not only for any particular member of any particular stock exchange but also other members of different stock exchanges. This new class of sub-brokers is not bound by any rules of stock exchanges. They share the commission or brokerage with the members of the stock exchanges with whom they deal. Most of the sub-brokers are active which encourages new issues of capital at centres like Amritsar, Surat, Chandigarh etc. where there are no full fledged stock exchanges. These sub-brokers are playing vital role to tap the rural savings for investment in industrial securities etc. There is need to regulate and control the activities of sub-brokers for proper functioning of stock market.

The recognised stock exchanges are the media through which Government regulation of the stock exchange is made effective. Where there are no stock exchanges the Securities Contracts (Regulation) Act, 1956, empowers Government to licence dealers in securities and prescribe the conditions to carry on the business of dealing in securities. Keeping in view of inadequate number of stock exchanges and fast spreading of investment cult to semi-urban and rural areas, there will have to be a
strict selection rules to select licenced dealers. There should be a network of sub-brokers and licenced dealers in the country to gear up the mobilisation of savings for investment in Industrial securities.

6.3 Trading mechanism

Stock exchange is a market where trading in securities takes place. The various provisions of the Securities Contract (Regulation) Act, 1956 empower the Central Government to prevent undesirable transactions in securities by regulating the dealings in securities. The members of the exchange are permitted to deal only in the listed securities in that particular stock exchange. The Governing Body of a particular stock exchange can permit to deal in those securities which are also listed on some other recognised stock exchange.

The bye-laws and regulations of the stock exchange govern various aspects of trading in securities in general, including procedure of settlement of bargains, carry over of transactions, delivery of securities, brokerage, rights and liabilities of members, procedure of arbitration between members, members and non-members, disciplinary action against members, reporting and monitoring the transactions, controlling the nature and volume of trading activity, regulating and safeguarding the security price fluctuations etc. The Stock Exchange provide facilities to investors for buying and selling of securities by permitting them to enter into different types of contracts. The
contracts\textsuperscript{10} may be for:

(a) Spot delivery i.e. for delivery and payment on the same day of the contract or the next working day;

(b) Hand delivery i.e. for delivery and payment within 14 days following the date of contract;

(c) Trading for settlement business in specified shares i.e. for delivery and payment through the clearing House, business being done in selected shares for not more than 10 business days, and all the transactions, being settled on specified dates, fixed in advance by the stock exchange in accordance with a schedule of dates; and

(d) Special delivery i.e. delivery and payment being completed within any time after 14 days following the date of contract.

Trading in stock exchange floor is conducted through a system of bids and offers. In case of gilt edged securities trading hours start at 12 noon and continue till 3.00 P.M. In view of the increasing volume of business in industrial securities, the duration of trading hours is short, which should be increased suitably.

6.3.1 Trading in Shares

The Stock Exchange is an auction market in shares. The trading commences at 12.00 noon. The orders are communicated
through telephone, telegrams, post teleprinter, telex services etc. whereby the members keep in constant touch with markets. As soon as the orders are reached, they are transmitted to the floor for execution. There are separate trading posts for different group of securities and which business in such securities is primarily transacted. The bids and offers are made and allowed and the bargain is closed at a price mutually agreed upon. The delivery and payment are then effected on the due dates of the contract.

The trading in stock exchanges, is mostly confined to industrial securities of public limited companies on the stock exchanges. The equity shares are divided into specified shares and non-specified shares for the purpose of trading. A broad basis of certain norms and distinct criteria are laid down for selection of specified shares. Different stock exchanges have their own list of cleared securities. Thus, there is need to fix standard norms and suitable criteria for selection of specified shares in all the stock exchanges.

6.3.2 Types of order and Settlement of Transaction

The specific orders are placed with the members in abbreviated form to reduce the cost. These orders are classified into limit order or fixed price order, net rate order, market rate order, best rate order, immediate or cancel order, stop loss order and open order. The bye-laws and regulations of buying and selling are more or less same in all the stock exchanges in India. These orders are placed through stock brokers only. The number of shares are traded in lot or in its multiple.
When the bargain is complete both parties make a brief note on their note book. Thereafter, the details of all the contracts executed are noted in a Pucca Sauda Book. The sale order involves same step as buy order i.e. placing an order with broker, execution of sale order, preparing contract note and receipt of payment.

The settlement of transaction takes place either in 'Cash' account or 'forward' account. In the cash account, dealings take place in Group 'B' cash specified shares whereas in the forward account Group 'A' specified shares are dealt with. In order to streamline the transaction, the stock exchange has formulated a procedure by which the settlement or the actual payment of cash and delivery of share certificate amongst the brokers will take place once every fifteen days.

6.3.3 Types of Margin

In order to check and control the speculative activities, three types of margin namely in specified shares carry over margin, daily margin, and adhoc margin are imposed. The daily margins are imposed on speculative securities in order to have a check and control on the rises or falls in prices. Generally, it does not exceed 10 percent of the contract price.

When some of the members conduct trading, which is beyond their financial resources, the stock exchanges impose adhoc margin on such members which is imperative to curb the speculative activities. There is no standard rate of such margin
like the daily margin when a transaction is carried over from one settlement to another settlement, the stock exchanges fixes the 'making up price'. The 'making up prices' are marked up and marked down by a uniform margin of 3 percent both from purchaser and seller respectively. It has been observed that there is no uniformity in fixing the margin. In order to control the speculative activities, there is need to check and control the margin which will effect the volume of trading by a member in the stock exchange.

6.3.4 Speculation

Speculation is deeply rooted in the trading mechanism of securities. There are four types of speculators i.e. bull, bear, stag and lame duck. It has been observed that stock market cannot be made active without the speculation. But excessive and unchecked speculation is very harmful. The main factors for the speculative activities are option dealings, curb market operations, insider trading, rigging up the market, carryover transactions, no check on the activities of members etc.

Under the Securities Contract (Regulation) Act, 1956, the option trading has been banned and made a cognizable offence. Despite this fact, option dealings are still practised in major stock exchanges in India. The insider trading involve misuse of confidential informations, which is unethical and it leads to betrayal of fidiciary position of trust and confidence.
This is an unhealthy practice and stock exchanges should take adequate steps to stop this practice. In India, no clear cut rules and regulations exist to control the insider trading under the Companies Act, 1956 and the Securities Contract (Regulation) Act, 1956.

The kerb trading also encourages the members and speculators to indulge in speculative activities. The short trading hour in the stock exchanges also stimulate the kerb trading in the market. Similarly, the rigging also creates instability in the market prices of the stock exchange and should be discouraged. Therefore, there is need for proper check and control on the undesirable activities to ensure free and fair trading in securities and provide stable market conditions.

The Patel Committee has also given various suggestion in this regard like perfect reporting system, close monitoring and supervisions, to gear up audit machinery, to discourage the undesirable activities, to review the rules, bye-laws and regulations of stock exchanges etc.

Keeping in view of the prevailing trading mechanism and increasing volume of industrial securities, there is need to take effective steps to improve the trading of securities and rationalise the trading mechanism.

6.4 Conclusion

The organisation of stock exchanges in India constitute limited companies by shares, companies limited by guarantee and as association of individuals. There is no uniform
model of organisation of stock exchanges in India. The Government of India has set up Securities and Exchange Board of India (SEBI) to promote the healthy development of securities market. The rules and regulations of membership in the stock exchanges are governed by the Securities Contracts (Regulation) Rules, 1957. The minimum educational qualification to become a member was matriculation or equivalent examination. The lack of qualified and professionalised members, inactive members, improper nomination system, lack of infrastructure facilities, inadequate financial strength, trading in own account by the brokers has inhibited the growth of stock exchanges in India. A new class of sub-brokers and licenced dealers has been encouraged to tap the savings of semi-urban and rural areas, where there is no stock exchange.

The members of the stock exchanges are permitted only to deal in listed securities. The stock exchange is an auction market in securities and trading take place from 12.00 noon to 3.00 P.M. Various types of orders like fixed price order, net rate order etc. and types of margin like carry over margin, daily margin and adhoc margin are executed and imposed respectively. The speculation is deep rooted in the trading of securities in the stock exchanges. Various undesirable activities like option dealings, insider trading, kerb trading, wash sales etc. has inhibited the growth of industrial securities. There is need to improve the present trading mechanism of securities in the stock exchanges.

***
References


6. Ibid; P.29.


