Chapter 2  
Indian Stock Market – A Profile

Stock market is one of the vigorous and active sectors in the financial system, making important contribution to the country’s economic development. It operates through a complex of institutions, instruments and mechanisms whereby funds are efficiently pooled, distributed and transferred to the economy of the country. Besides efficiently mobilising financial resources for investment, providing liquidity for the investors, monitoring and disciplining company management are the other important functions of the stock markets. Because of that an efficient stock market is considered indispensable for the rapid economic development of a country. It is regarded as the economic barometer of a country indicating the nature and level of economic activity at any point of time.

As a background to our study this chapter examines the origin, growth, weakness, recent reforms and developments in the Indian stock market.

2.1 Origin and Growth of Stock Market in India

The origin of stock market in India can be traced to the end of the 18th century when the securities of East India Company were traded in Bombay (now, Mumbai) and Calcutta (now, Kolkata). During that time brokers used to gather under a banyan tree in Mumbai and under a neem tree in Kolkata to trade in securities. The real beginning came in the 1850s with the enactment of Companies Act, which introduced joint stock companies with limited liability. Besides this, development in the means of communication and transport also encouraged the development of joint stock companies in large numbers. In Mumbai high speculation in securities dealings during 1860s brought brokers together and in July 1875 they formed first formally organised stock exchange in India viz “The Native Shares and Stock Brokers Association”, which is now popularly known as Bombay Stock Exchange (BSE). The BSE is one of the premier stock exchanges in India and the oldest in Asia.

The second stock exchange came into existence in 1894 under the name of “The Ahmedabad Shares and Stock Brokers Association” and later, the name of this exchange was changed to Ahmedabad Stock Exchange. In the year 1908 the Calcutta Stock Exchange Association came into existence and later it is called Calcutta Stock Exchange. The Indore Stock Exchange came into existence in 1930, Madras Stock
Exchange in 1937, Hyderabad Stock Exchange in 1943 and Delhi Stock Exchange in 1947. As a result, during 1947 there were 7 stock exchanges in India.

In 1956, the Government of India passed a comprehensive legislation for regulating the functioning of stock exchanges in India, known as the Securities Contracts (Regulation) Act, 1956. Section 2(3) of the Securities Contracts (Regulation) Act, 1956 defined the stock exchange as "any body of individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities." This legislation also made it mandatory for all existing as well as future stock exchanges to secure recognition from the central government. On their applications, the central government granted recognition to only established stock exchanges at Bombay, Ahmedabad, Kolkata, Madras and Delhi in 1957, Hyderabad and Indore in 1958, and Bangalore Stock Exchange in 1963. Except these eight stock exchanges, the central government refused to recognise all other stock exchanges and as a result, they ceased their functions. Therefore, during early 1960’s there were only 8 recognised stock exchanges in India. The number of stock exchanges remained unchanged for nearly 17 years. During 1980’s many stock exchanges were recognised under the Securities Contracts (Regulation) Act, 1956. These were Cochin Stock Exchange (1979), Uttar Pradesh Stock Exchange Association at Kanpur (1982), Pune Stock Exchange (1982), Ludhiana Stock Exchange Association (1983), Gauhati Stock Exchange (1984), Kanara Stock Exchange at Mangalore (1985), Magadh Stock Exchange Association at Patna (1986), Jaipur Stock Exchange (1989), Bhuvaneshwar Stock Exchange Association (1989), Saurashtra Kutch Stock Exchange at Rajkot (1989), Over the Counter Exchange of India [OTCEI (1989)], Vadodra Stock Exchange at Baroda (1990), Coimbatore Stock Exchange (1991), National Stock Exchange of India Limited (1992), and Inter Connected Stock Exchange of India Ltd [ICSEI (1998)]. At present, there are 23 stock exchanges in India, out of these, only 8 stock exchanges are given permanent recognition and the remaining are given temporary recognitions, renewable periodically.

In India, stock exchanges have been constituted on different ideologies, i.e., public limited company, company limited by guarantee, an association of individuals, non-profit making association, etc. In order to bring uniformity among the stock exchanges on March 13, 2001, the then finance minister made an announcement in the parliament about “corporatisation of stock exchanges.” The corporatisation of stock
exchanges segregates ownership, management and trading membership from each other. According to the instruction issued by finance minister, SEBI constituted a 'committee on corporatisation and demutualisation of stock exchanges' under the chairmanship of Justice M H Kama, former Chief Justice of India, to recommend the steps that required to be taken to implement the same. SEBI accepted all the recommendations of Kama committee except that in the case of NSE, the present structure of its board would be maintained and the voting rights of the shares held by the broker members would be determined by SEBI in consultation with the government of India. The government of India in the month of October 2004 promulgated an ordinance to amend the Securities Contracts (Regulation) Act (SCRA), 1956 in an attempt to remove legal hurdles and to facilitate reforms such as demutualisation and corporatisation of stock exchanges, creation of Indonext trading platform, an alternative trading platform for small and medium enterprises (SMEs) to raise equity and debt from the capital market, and conversion of clearing houses into corporations on priority basis.

One of the important features of Indian stock market is the phenomenal increase in the turnover over the years, which is shown in the Table 2.1 A glance at the Table 2.1 reveals phenomenal growth in the turnover at the stock exchanges during the last 10 years. However, increase in turnover has not been uniform across the years. The turnover was Rs 1,64,057 crore in 1994-95 as compared to as high as Rs 2,27,368 crore in the year 1995-96. This was very low compared to Rs 6,46,116 crore turnover in 1996-97. In 1997-98 the turnover of all stock exchanges in India increased to Rs 9,08,691 crore from Rs 6,46,116 crore in 1996-97, an increase of 40.6 percent. During 1998-99 in absolute term the turnover went up to Rs 10,23,381 crore, an increase of only 12.6 percent as compared to phenomenal growth of 40.6 percent in 1997-98. In the year 1999-2000 total turnover was Rs 20,67,030 crore as compared to Rs 10,23,381 crore in 1998-99, recording substantial growth of 101.89 percent. The total turnover was Rs 28,80,990 crore in 2000-01 as compared to Rs 20,67,030 crore in 1999-2000, recording a growth of 39.38 percent during the year.
Table 2.1: Turnover on Stock Exchanges in India

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of Stock Exchanges</th>
<th>Total Turnover (Rs in Cr)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995-96</td>
<td>22</td>
<td>1,64,057</td>
</tr>
<tr>
<td>1996-97</td>
<td>22</td>
<td>2,27,368</td>
</tr>
<tr>
<td>1997-98</td>
<td>22</td>
<td>6,46,116</td>
</tr>
<tr>
<td>1998-99</td>
<td>22</td>
<td>9,08,691</td>
</tr>
<tr>
<td>1999-00</td>
<td>22</td>
<td>10,23,381</td>
</tr>
<tr>
<td>2000-01</td>
<td>23</td>
<td>20,67,030</td>
</tr>
<tr>
<td>2001-02</td>
<td>23</td>
<td>28,80,990</td>
</tr>
<tr>
<td>2002-03</td>
<td>23</td>
<td>8,95,817</td>
</tr>
<tr>
<td>2003-04</td>
<td>23</td>
<td>9,68,909</td>
</tr>
<tr>
<td></td>
<td></td>
<td>16,20,497</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Reports 1995-96 to 2003-04

During the year 2001-02, stock market was dominated by bearish sentiment. Almost all major stock market indicators like market capitalisation, turnover, and P/E ratio showed a sharp decline. Stock prices suffered several reversals during the year on account of many factors such as investors' perception of slow down of global economy, bearish movement in the American stock market following the terrorist attack on World Trade Center (WTC) on September 11, 2001. The surfacing of irregularities in the trading of shares on the Indian stock market that involved Kethan Parekh, the stockbroker of the BSE, during March 2001, etc. dampened the investors' sentiment on the equity market. During the year 2001-02 total turnover of all the 23 stock exchanges in India declined from Rs 28,80,990 crore in 2000-01 to Rs 8,95,817 crore, a substantial decline of 321.6 percent and shattered the confidence of investors in the Indian stock market. During the year 2002-03 total turnover increased from Rs 8,95,817 crore to Rs 9,68,909 crore, an increase of 8.2 percent compared to the year 2001-02. In the year 2003-04 turnover was Rs 16,20,497 crore which is a substantial increase compared to Rs 9,68,909 crore in 2002-03, an increase of 67.25 percent.

One of the important milestones in the growth of Indian stock market is the establishment of National Stock Exchange (NSE), Over the Counter Exchange of India (OTCEI), and Inter Connected Stock Exchange of India (ICSEI). The establishment of the NSE in November 1992 is a significant development in the
The history of Indian stock market. The capital market segment of NSE commenced trading in equities on November 3, 1994. In a short span of a decade, the NSE has emerged as the dominant stock exchange of India. NSE has out-performed Bombay Stock Exchange (BSE), partly due to its state-of-the-art technology. But the more important reason for NSE's success has been its business model that yields best results, particularly under competitive conditions. Because of its highly efficient trade and settlement systems, computerised nationwide network, it has captured most of the trading volumes from all other stock exchanges. All the stock exchanges, other than the BSE, have almost been on the way to close their business, as they could not compete with the NSE. In the derivative segment, NSE has acquired monopoly over the BSE and BSE is struggling for its existence. The success of NSE can be attributed to the spread of computer network throughout India, which made investors at large to participate in the equity market. Following the NSE, in March 1995, BSE has also introduced screen based trading called BOLT (BSE On-Line Trading).

Another important type of stock exchange established in India is Over the Counter Exchange of India (OTCEI) based on the model of NASDAQ (National Association of Securities Dealers Automated Quotation) and JASDAQ (Japanese Association of Securities Dealers Automated Quotation). The formal approval of the government for the setting up of the OTCEI was granted in August 1989 under the Securities Contracts (Regulation) Act, 1956, but the actual operations started in October 1992. The main objective of the establishment of OTCEI is to provide market for smaller companies that could not afford to pay the listing fees of the big stock exchanges and did not fulfill the minimum capital requirement for listing in the BSE and the NSE.

The establishment of Inter-Connected Stock Exchange of India (ICSEI) is another significant aspect of growth of stock markets in India. It started functioning from August 29, 1998. Inter-Connected Stock Exchange of India is a diluted version of the National Stock Market System (NSMS) recommended by the M.J. Pherwani committee. The main objectives of ICSEI is to interconnect the 15 odd regional stock exchanges of India to ensure liquidity and to minimise the cost of the regional exchanges as they were incurring huge costs by supporting very illiquid stocks.
2.2 Foreign Institutional Investors (FIls)

Foreign Institutional Investors (FIls) are playing an important role in the growth of Indian capital market. Investments of FIls have been increasing substantially during the last decade and therefore, they have become an important segment of Indian capital market. Table 2.2 presents information related to purchases, sales, net investment (in rupees) and dollars and cumulative position of FIls investment for the 12 years.

**Table 2.2: Investment of Foreign Institutional Investors**

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>1992-93</td>
<td>17</td>
<td>4</td>
<td>13</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>1993-94</td>
<td>5,593</td>
<td>466</td>
<td>5,126</td>
<td>1,634</td>
<td>1,638</td>
</tr>
<tr>
<td>1994-95</td>
<td>7,631</td>
<td>2,835</td>
<td>4,796</td>
<td>1,528</td>
<td>3,167</td>
</tr>
<tr>
<td>1995-96</td>
<td>9,694</td>
<td>2,752</td>
<td>6,942</td>
<td>2,036</td>
<td>5,202</td>
</tr>
<tr>
<td>1996-97</td>
<td>15,554</td>
<td>6,979</td>
<td>8,574</td>
<td>2,432</td>
<td>7,634</td>
</tr>
<tr>
<td>1997-98</td>
<td>18,695</td>
<td>12,737</td>
<td>5,957</td>
<td>1,650</td>
<td>9,284</td>
</tr>
<tr>
<td>1998-99</td>
<td>16,115</td>
<td>17,699</td>
<td>-1,584</td>
<td>-386</td>
<td>8,898</td>
</tr>
<tr>
<td>1999-00</td>
<td>56,856</td>
<td>46,734</td>
<td>10,122</td>
<td>2,339</td>
<td>11,237</td>
</tr>
<tr>
<td>2000-01</td>
<td>74,051</td>
<td>64,116</td>
<td>9,934</td>
<td>2,158</td>
<td>13,396</td>
</tr>
<tr>
<td>2001-02</td>
<td>49,920</td>
<td>41,165</td>
<td>8,755</td>
<td>1,846</td>
<td>15,242</td>
</tr>
<tr>
<td>2002-03</td>
<td>47,061</td>
<td>44,373</td>
<td>2,689</td>
<td>562</td>
<td>15,805</td>
</tr>
<tr>
<td>2003-04</td>
<td>1,44,858</td>
<td>99,094</td>
<td>45,767</td>
<td>9,950</td>
<td>25,755</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>4,46,045</strong></td>
<td><strong>3,38,954</strong></td>
<td><strong>1,07,089</strong></td>
<td><strong>25,755</strong></td>
<td><strong>25,755</strong></td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report 2003-04

During the year 2003-04 foreign institutional investors have been permitted to invest in financial derivatives. During the year 2003-04 they have showed maximum interest in stock futures, accounting for about 80 percent of the total open interest and lowest interest in index options. Their second highest investment is on index futures, while stock options attracted negligible investment. Because of the presence of FIls, small investors, who earlier constituted the backbone of Indian stock market, have been gradually replaced by FIls. Most of the times the indices and stock prices
fluctuate according to FIIs buying and selling trend. The above Table indicates gradual increase in the investment, except in 1998-99 in which there was net outflow of Rs 1,584 crore (US $ 386 million). From the table it is clear that in 1992-93 net investment by FIIs was Rs 13 crore (US $ 4 million) and increased to Rs 5,126 crore (US $ 1,634 million) in 1993-04, an increase of Rs 5,113 crore (US $ 1,630 million). During the 1997-98 net investments was Rs 5,957 crore (US $ 1,650 million), as against Rs 8,574 crore (US $ 2,432 million) a decline of 30.52 percent. In the year 1998-99 there was a net outflow of Rs 1,584 crore (US $ 386 million) as against Rs 5,957 crore (US $ 1,650 million), a fall of 126.59 percent. During the year 1999-00 net investments increased to Rs 10,122 crore (US $ 2,339 million) compared to net outflow of Rs 1,584 crore (US $ 386 million) in 1998-99, an increase of 539 percent. During 2000-01 and 2001-02 there was a gradual decline in net investment to the extent of 18.6 percent and 11.87 percent respectively. During the year 2002-03 net investments was as low as Rs 2,689 crore (US $ 562 million) as against Rs 8,755 crore (US $ 1,846 million) during the preceding year, a sharp decline of 225.59 percent. This was due to global recession, wars in Afghanistan and Iraq and negative sentiments of investors globally, etc. To encourage FIIs to invest in Indian stock market, during the year 2002-03, SEBI simplified procedures for registration and registration fee was reduced from US $ 10,000 to US $ 5,000. As a result, it is clear from Table 2.2 that during the year 2003-04 net investment by FIIs went up to Rs 45,767 crore (US $ 9,950 million) as against Rs 2,689 crore (US $ 562 million) in 2002-03, an increase of 1,602 percent. The cumulative investments of FIIs stood at Rs 1,07,089 crore (US $ 25,755 million) as on March 31, 2004. In the budget 2004-05 the finance minister emphasised on simplifying and speeding up of procedures for registration and operations for FIIs and raised the investment ceiling for FIIs in debt funds from US $ 1.00 billion to US $ 1.75 billion. FIIs have been allowed to participate in delisting offers to give an exit opportunity. They are also allowed to participate in sponsored ADR/GDR programmes and permitted to participate in divestment by the government in listed companies. Moreover, Foreign Direct Investment (FDI) cap rose from 26 percent in insurance sector to 49 percent, from 49 percent in telecom to 74 percent, from 40 percent in civil aviation to 49 percent and from 49 percent in private banks to 74 percent. All these measures are expected to contribute favourably to increase inflow of foreign investment in India in the coming years.
2.3 Weakness of Indian Stock Market

Indian stock market suffers from many weaknesses Bhole and Pattanaik (2002) rightly stated

"Indian stock market has a number of weakness, drawbacks, lapses and malpractices It can hardly be claimed that the Indian stock market is a fair, transparent and efficient market with high integrity One constantly comes to know about its problems such as insider trading, broker defaults, vanishing companies, counter party risk, delayed settlements, market manipulations and rigging, issue related manipulations, frauds, scams” (p 175)

2.3.1 Increase in the Number of Cases

Though Securities and Exchange Board of India (SEBI), being regulator, carry out investigations to examine alleged violations and to gather evidence and identify persons/institutions/companies behind these irregularities and violations in spite of these efforts, it is evident from Table 2.3 that the number of cases registered with SEBI has been increasing year after year.

Table 2.3 focuses on cases taken up for investigation and completed by the SEBI. The Table reveals that during 1994-95 SEBI had taken up 2 cases and completed In the year 1995-96 the number of cases increased from 2 in 1994-95 to 60, an increase of 2,900 percent and SEBI completed investigation of only 18 cases (30 percent of cases registered) During the year 1996-97 the number of cases increased to 122 as compared to 60 in 1995-96, an increase of 103.33 percent and SEBI completed the investigation of only 55 cases (45.08 percent) From 1997-98 to 2000-01 the number of cases taken up for investigation by SEBI was 53, 55, 56 and 68 and completed investigation of 46, 60, 57 and 46 respectively. During 2001-02 again the number of cases were increased from 68 in 2000-01 to 111, an increase of 63.24 percent and SEBI completed investigation of only 29 cases (26.13 percent) as against 46 cases (67.65 percent)
During 2002-03 number of cases taken up for investigation was 125 as against
111 cases in 2001-02, an increase of 12.61 percent and completed investigation of 106
cases (84.80 percent) During 2003-04 the number of cases taken up for investigation
decreased from 125 in 2002-03 to 121, a decline of 3.2 percent As we can see from
the above table the focus on and intensity of investigations have gone up during the
last two years During 2003-04, SEBI completed investigations of 152 cases as
against 106 in the previous year, an increase of 43.39 percent The analysis of the
Table 2.3 clearly reveals that Indian stock market is not efficient, transparent and not
free from manipulations in spite of SEBI’s effort to make it on a par with developed
markets in the world

2.3.2 Insider Trading

Insider trading refers to operating on information, which is price sensitive and
not available to the public By the time the information is made public, greater portion
of it already been reflected in stock prices and affects buyers and sellers Spreading
rumours is another method of exploiting the inside information. Rumours are spread
in such a way that prices move in the direction opposite to the expected direction on
the public announcement of the information For example, it results in the creation of
bearish trend instead of bullish and vice versa In this way investors involved in
Insider trading is banned in developed countries like USA, UK, etc. In India, SEBI (Insider Trading) Regulations, 1992, was enacted and came into effect in November 1992. The provisions of the Act entrusted SEBI with wide ranging powers for prohibition on dealing, communicating or counseling on matters relating to insider trading in order to make Indian stock market fair, transparent, free from manipulations, price rigging, and insider trading and to enhance investors' protection, SEBI had taken initiative to amend SEBI (Insider Trading) Regulations, 1992. A group was set up under the chairmanship of Shri Kumar Mangalam Birla, to suggest measures to be taken for strengthening of the regulations as well as requirements of procedures and code of conduct. The Insider Trading (Amendment) Regulations were notified on February 20, 2002. The changes such as strengthening existing provisions of the Act, incorporation of disclosure requirements by insider and creation of preventive framework have been made through the amendment regulations for enhancing market transparency and for strengthening the insider trading regulations. Again during 2003-04 SEBI reviewed and made amendment to SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2003. In spite of these provisions, insider trading is increasing, which is evident from the increasing number of cases filed with the SEBI in the recent years. There were 6, 16, 13, and 14 complaints of insider trading during 2000-01, 2001-02, 2002-03, and 2003-04 respectively. The break up of the number of cases in Table 2.4 indicates that out of total complaints filed with the SEBI, 8.8 percent, 14.4 percent, 10.4 percent, and 11.5 percent of the cases were related to insider trading during 2000-01, 2001-02, 2002-03, and 2003-04 respectively. The best method to reduce insider trading is to reduce the scope of making profit from it. This can be achieved by ensuring speedy availability of price sensitive information to the public.

### 2.3.3 Lack of Liquidity

Liquidity refers to the ability of the market to buy or sell securities. A high turnover ratio is associated with low transaction cost and active market. Though, Indian stock market is the second largest market in the world in terms of number of listed stocks, the majority of the stocks are either not traded or traded very infrequently. According to SEBI as on 31st March 2004 more than 4,000 stocks have...
not been traded for past several years and tracing of the company is difficult (The Economic Times, April 7, 2004) However, recently SEBI has developed plans to bring 4,000 illiquid shares back to trading. SEBI has the plan to create a new segment called ‘call auction market’, which allow investors to buy and sell these shares. In this segment order book may be open for longer period and settlement period to be longer than T+3.

2.3.4 Concentration of Business on NSE and BSE

One of the serious problems of Indian stock market is the concentration of business on NSE and BSE. Because of poor liquidity at regional stock exchanges NSE has captured most of the trading volumes from all the other exchanges. NSE also has highly efficient trading and settlement systems than any of the stock exchanges in India. All the stock exchanges other than BSE, have almost on the way to close their business, as they could not compete with NSE as indicated by Table 2.7 below.

Table 2.7: Percentage of Turnover on Different Stock Exchanges in India

<table>
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</thead>
<tbody>
<tr>
<td>NSE</td>
<td>38.78</td>
<td>46.56</td>
<td>64.82</td>
<td>63.53</td>
<td>70.98</td>
<td>73.73</td>
<td>81.20</td>
<td>91.59</td>
<td>96.20</td>
<td>99.90</td>
</tr>
<tr>
<td>BSE</td>
<td>101</td>
<td>26.70</td>
<td>45.58</td>
<td>40.71</td>
<td>40.49</td>
<td>40.59</td>
<td>46.49</td>
<td>57.28</td>
<td>63.78</td>
<td>62.95</td>
</tr>
<tr>
<td>Punjab</td>
<td>6.94</td>
<td>8.18</td>
<td>3.18</td>
<td>3.39</td>
<td>2.91</td>
<td>1.82</td>
<td>1.88</td>
<td>1.66</td>
<td>1.60</td>
<td>0.00</td>
</tr>
<tr>
<td>Rajasthan</td>
<td>4.42</td>
<td>4.91</td>
<td>2.49</td>
<td>1.69</td>
<td>1.82</td>
<td>1.16</td>
<td>0.86</td>
<td>2.82</td>
<td>1.52</td>
<td>0.02</td>
</tr>
<tr>
<td>Delhi</td>
<td>5.10</td>
<td>4.00</td>
<td>7.53</td>
<td>7.47</td>
<td>5.06</td>
<td>4.51</td>
<td>2.91</td>
<td>0.65</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Other</td>
<td>15.29</td>
<td>11.69</td>
<td>5.63</td>
<td>4.25</td>
<td>2.74</td>
<td>1.5</td>
<td>0.83</td>
<td>0.26</td>
<td>0.01</td>
<td>0.00</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
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</tbody>
</table>

Source: SEBI Annual Reports from 1997-98 to 2003-04

The performance of all the stock exchanges in India can be viewed from Table 2.7 in terms of their share in the total turnover of all the stock exchanges in India. The turnover widely varied among the stock exchanges. It can be observed from the Table 2.7 that the percentage share in turnover of NSE and BSE is continuously increasing while other 21 stock exchanges shows a declining trend. The total share of NSE and BSE during the year 1994-95 to 2003-04 was 38.78 percent, 46.56 percent, 64.82 percent, 63.53 percent, 70.98 percent, 73.73 percent, 81.20 percent, 91.59 percent, 96.20 percent and 99.90 percent respectively. While the total share of other 21 stock...
exchanges for the same period was 15.29 percent, 11.69 percent, 35.18 percent, 36.47 percent, 29.02 percent, 26.27 percent, 18.80 percent, 8.41 percent, 3.8 percent and 0.01 percent respectively. This clearly shows that NSE and BSE have monopoly over other 21 stock exchanges. The percentage of turnover on NSE during the year 1994-95 to 2003-04 was 1.01 percent, 26.70 percent, 45.58 percent, 40.71 percent, 40.49 percent, 40.59 percent, 46.49 percent, 57.28 percent, 63.78 percent, and 62.95 percent respectively, while the percentage of turnover on BSE was 37.77 percent, 19.86 percent, 19.24 percent, 22.82 percent, 30.49 percent, 33.14 percent, 34.71 percent, 34.31 percent, 32.42 percent and 36.95 percent respectively. This supports the fact that NSE completely outperformed the BSE and from 2002-03 onwards more than 60 percent of total turnover of all the 23 stock exchanges is concentrated on NSE.

2.3.5 Inadequate Infrastructure

Except NSE and BSE, the infrastructure in the stock exchanges in India is inadequate. Other than the premier stock exchanges, stock exchanges in India are facing the problems of inadequate office space, lack of computerisation, ineffective communication system, shortage of qualified and sincere manpower, etc. These inadequacies have affected the quality of services provided by the stock exchanges. Besides these problems, the number of brokers who bring investors, both buyers and sellers, together to make aggregate demand and supply at any point of time in the stock exchanges are not sufficient to provide proper services to the investors who are scattered throughout the world.

As on March 31, 2004, the total number of brokers stood at 9,368 as compared to 9,519 as on March 31, 2003, a decline of 15 percent. The numbers of brokers are, not only small, they are also inactive. During the year 2002-03, 92 percent of brokers were active in NSE, 73.2 percent in BSE and in other stock exchanges it was less than 45 percent. Compared to 2002-03, the activities of brokers came down in all the stock exchanges during 2003-04. During 2003-04 approximately 90 percent of NSE brokers are active while 72 percent at BSE. In some stock exchanges less than 25 percent of brokers are active and in many exchanges, not even a single broker is active (SEBI Annual Report 2004, p. 41). Moreover, all the brokers have an assured volume of business. This reduced the level of competition among the brokers and also the services provided by them to the investors. Lack of infrastructure increases
transaction cost, delays settlement that can slow down the absorption of price sensitive information affecting efficiency of the market

2.3.6 Securities Scam 1992

Securities scams in 1992 and 2001, UTI scandal in 1998 shattered the confidence of investors in Indian stock market. According to Barua and Varma (1993) “the term ‘securities scam’ refers to the diversion funds from the banking system to various stock brokers in a series of transactions – primarily government securities – during the period April 1991 to May 1992” (p 3) There was a significant rise in the BSE sensitive index in the first quarter of 1992 when index moved from 2,302.5 in January 1992 to a peak of 4,467.32 on April 22, 1992 In April 1992 news on shortage in the government securities held by the State Bank of India appeared in the newspaper. The investigations revealed misappropriation of funds to the extent of Rs. 3,500 crores This was popularly called “securities scam” in which executives of nationalised banks, foreign banks, financial institutions, brokers, and bureaucrats were involved

The central government in order to speed up legal processes promulgated an ordinance and set up a special court to try those involved in the scam The ordinance declared all transactions done by the accused brokers and their firms after April 1, 1991 as void and instructed to attach the properties of all the parties involved in the scam. This created confusion and panic among investors, brokers, stock exchanges, and general public As a result there was a sharp decline in the stock indices, more than 40 percent decline in share prices, and wiped out market capitalisation to the extent of Rs 1,00,000 crore Because of the scam, the government’s liberalisation policy came under severe criticism SEBI postponed sanctioning of private sector mutual funds. Important issues such as privatisation, liberalisation, and globalisation took a back seat

2.3.7 UTI Scam 1998

Excessive exposure to equity in a declining market and payment of high dividend beyond the net income on US-64 scheme and negligence by the Unit trust of India (UTI) were the main reasons for UTI Scam 1998 On June 28, 1998, P Subramanyam, the then chairman of UTI, made it public that US-64’s reserves were less than what was required The same appeared in the newspapers, TV, radio, etc on the next day and compelled the chairman of UTI to disclose the scheme’s Net Asset
Value (NAV) The US-64's financial statement for the year ended June 1997 revealed that it was a big problem due to sharp decline in the BSE sensex and its reserves were less than what is required. Despite this UTI declared dividend, without preparing financial statements and collected Rs 3,105 crore from the capital market in July 1998 to solve its liquidity problem that resulted from payment of dividend.

Along with reserves less than what was required in US-64 scheme, Subramanyam, the then chairman of UTI on October 2, 1998 declared that UTI intended to reduce its equity holdings in US-64's portfolio by selling in the market. This created confusion and panic among the investors because UTI, one of the powerful buyers became a seller. As a result, stock market crashed on October 5, 1998 and ended with a sharp fall from 3,036 15 opening to 2,878.07, a fall of 158.08 points (5.21 percent).

2.3.8 Securities Scam 2001

The then finance minister Smt Yashwanth Sinha presented his dream budget on February 28, 2001. He announced major reforms in the capital market and also made reforms in sectors like financial, power, pharmaceuticals, sugar, oil and fertilizer. He reduced dividend tax to 10 percent. The other reforms are discussed in the section on reforms and developments in the stock markets. Because of these measures, the BSE sensex ended at 4,247.04 as against opening at 4,070.37, gaining a record of 177 points on budget day. On March 2, 2001 stock market witnessed one of the steepest fall. The BSE sensex lost the entire post budget gains and finally closed at 4,095 as against 4,272 on March 1, 2001, with a loss of 177 points. The market crash was attributed to selling pressure in new economy stocks such as information, communication and entertainment stocks. Foreign Institutional Investors (FIIs) were also aggressive sellers on tech counters and because of the last day of settlement, a lot of brokers began to unwind their long positions. The market was full of rumours of a payment crisis on the BSE. For the week ended March 2, 2001, the value of short sold stock was as huge as Rs 64 crore. On March 13, 2001 market witnessed a very volatile session with the BSE sensex swinging between an intra day low of 3,436.75 and an intra day high of 3,777.48. On the same day, Tehelka.com released videotapes showing some defense personnel and ruling party politicians in a bribery scandal that added fuel to the fire and the sensex closed at 3,540.65. Market was volatile amidst rumours of a payment crisis on the Calcutta Stock Exchange (CSE) and ban on short
sales by SEBI, and remained volatile till March 29, 2001. On March 30, 2001, Kethan Parekh’s alleged involvement in the Madhavpura Mercantile Co-operative Bank’s pay order scam came to light. Bank of India (BOI), the recipient of the Rs 137 crore worth pay order drawn on Madhavpura Mercantile Co-operative Bank, filed a criminal complaint against Kethan Parekh with the Central Bureau of Investigation (CBI). Market was full of rumours related to Kethan Parekh’s arrest by CBI in connection with pay order default of Rs 130 crore. Finally, he was arrested in the evening. The Calcutta Stock Exchange’s governing board resigned to make way for SEBI to clean up the system. On March 30, 2001, the sensex eventually settled at 3,604, losing 147 points.

In this process, Anand Rathi, the then president of BSE, expelled from the office before the end of the term because of his conversation with an official of the surveillance department on March 2, 2001 and passing on the sensitive information about the outstanding long and short positions in the various stocks that he got from the surveillance department to a bear cartel. In a bold move, SEBI banned carry forward trading, shifted another 246 scrips to rolling settlement with effect from July 2, 2001 and introduced uniform settlement on the remaining scrips.

2.4 Reforms and Developments in the Indian Stock Market

A major phenomenon of the last century has been large growth in the size of business units and growth in their financial requirements. As a part of liberalisation, the stock market in India has been assigned an important place in financing the corporate sector. Besides mobilising financial resources for investment, providing liquidity for the investors and monitoring company management are other important functions of the stock market. The decade of 1990s had seen remarkable reforms in the Indian stock market. The Economic Survey 1992-93 report, presented to parliament by the Finance Minister on the eve of the presentation of the union budget, observed that:

The process of reforms in the stock market needs to be deepened to bring about speedier conclusion of transactions, greater transparency in operations, improved services to investors, and greater investor protection while at the same time encouraging corporate sectors to raise resources directly from the market on an increasing scale. Modernisation of the stock exchanges to bring
The securities market reforms were based on the recommendations of the Pherwani, Dave, Nadkarni and Narasimham committees and the Standing High Level Committee on Capital Markets. Significant reforms and developments in the Indian stock market since 1992 can be summarised as follows.

2.4.1 Scrapping Controller of Capital Issues (CCI)

Pricing of public issues and fixing of premium was the main function of Controller of Capital Issue (CCI) and sometimes, CCI used to force the companies to issue shares to the market at discount. Government of India repealed Capital Issues (Control) Act of 1947 and abolished CCI in March 1992 and this statutory power was conferred to SEBI. As a result, issuers have the freedom to fix price for their issues and it is left to the market to decide the appropriateness of pricing of securities.

2.4.2 Establishment of Securities and Exchange Board of India (SEBI)

Securities and Exchange Board of India (SEBI) was formed in 1988 and legal powers to regulate stock market were delegated in February 1992 by passing SEBI Act, 1992. Four statutory objectives mentioned in the SEBI Act, 1992 are: a) protection of the interest of investors in securities, b) Development of the securities market, c) Regulations of the securities market, and d) Matters connected therewith and incidental thereto. SEBI has been constantly reviewing and reappraising its policies and programmes, formulating new policies and regulations to cover unregulated areas, initiating reforms and implementing them in a way so as to promote the growth of the stock market with transparency, fairness, efficiency and integrity. Since its existence, SEBI has initiated many landmark reforms and development programmes. It is striving hard to fulfill its vision “to be most dynamic and respected regulator globally.” Day by day government is delegating more power to SEBI. According to the Securities Laws (Amendment) Ordinance 2004 issued by the Government of India in October 2004 SEBI can slap a penalty up to Rs. 25 crore if stock exchanges fail or neglect to furnish periodical returns to the SEBI or fails to make or amend its rules or bye laws as directed by the regulator. The same ordinance has given power to SEBI to impose penalty up to Rs 25 crore also on companies.
which dematerialises more than the issued securities of a company or delivers in the stock exchanges the securities, which are not listed, or delivers securities where no trading permission has been given by the stock exchange

2.4.3 Introduction of Dematerialisation

The decade of the 1990s witnessed a revolution in the clearing and settlement functions in the Indian stock market. Promulgation of the Depositories Ordinance in 1995 and the establishment of National Securities Depositories Ltd. (NSDL) in October 1996 and Central Depository Services Ltd (CDSL) in February 1999 helped to eliminate the problems associated with paper-based securities systems such as delay in transfer, bad delivery, theft, fake and forged shares, etc. SEBI, being the regulator, made it compulsory for selected groups of investors to make settlement of trades in certain stocks in dematerialised form initially and later on extended to all the investors. As on March 31, 2004, 5,216 and 4,810 companies signed up with NSDL and CDSL respectively. For the same period, the number of shares dematerialised has also gone up to 8,36,935 lakh and 1,40,100 lakh at NSDL and CDSL respectively.

2.4.4 Introduction of Derivatives Trading

A derivative is an instrument whose value is derived from the value of one or more underlying, which can be commodities, precious metals, currency, bond, stocks, stock indices, etc. Four most common examples of derivative instruments are Forwards, Futures, Options, and Swaps.

BSE and NSE are among a few stock markets in the world that allow trading on index options, index futures, stock options, and stock futures. BSE launched index futures on sensex on June 9, 2000, sensex options in June 2001, stock options in July 2001 and stock futures in November 2001. NSE introduced trading in Nifty futures on June 12, 2000, Nifty options in June 2001, and stock option in July 2001 and stock futures in November 9, 2001. Between these two exchanges, NSE has a lion’s share. As on March 31, 2004 on NSE the total number of contracts traded on index futures was 1,71,92,274 (98.59 percent of total) as against 2,46,443 (1.41 percent of total) on BSE. The total number of contracts on stock futures on NSE was 2,89,68,842 (99.56 percent of total) as against 1,28,193 (0.44 percent of total) on BSE. For the same period, on NSE total number of contracts traded on index call option was 10,43,894 and index put option was 42,48,149 and put option
was 13,38,654 as against this BSE recorded zero volume turnover in the index option segment

To bring Indian securities market on a par with markets of developed countries, SEBI permitted stock markets to issue new derivative products. Accordingly, interest rate futures contracts were introduced in June 2003 and options contacts on sectoral indices have been introduced in August 2003. FIIs and NRIs have been permitted to invest in all exchange traded derivative contracts and stockbrokers have been allowed to trade in commodity derivatives

2.4.5 Ban on Badla

A revised carry-forward system introduced in October 1995 replacing the old badla system, which was banned in March 1994. In the revised carry forward system, a twin track trading system was recognised, where trades in carry forward and cash mode are segregated at the time of the trade. SEBI imposed a 90 day limit for carry forward trades and Rs 10 crore limit on financier funding and bans carry forward beyond Rs 50 lakh in a scrip. In July 2001, SEBI banned badla and introduced options and futures on index and individual stocks, and moved more than 414 stocks under compulsory rolling settlement of T+2.

2.4.6 Introduction of Rolling Settlement

Rolling settlement was introduced by SEBI for the first time in 1998 by making it optional for demat scrips. Initially rolling settlement was implemented on a T+5 basis (Trade Plus 5 days). On April 2, 2002 settlement cycle was reduced from T+5 to T+3 and on April 1, 2003 it is moved to T+2. At present, Indian stock market clears and settles all transactions on T+2 (Trade Plus 2 days). In the beginning SEBI selected 10 scrips for rolling settlement and at present more than 414 scrips are in the rolling settlement. Now there is a proposal to reduce this to T+1. According to SEBI (2004), a study has been conducted to identify cost and benefits of shifting from T+2 to T+1. The study found a cost benefit ratio of 0.85. This means for every likely expense of 85 paisa, there will be benefit of Re 1. Total estimated cost roughly amounts to Rs 45.40 crore and benefits Rs 53.50 crore.

Internationally, the rolling settlement has been accepted as the best method of settling trades. In the rolling settlement, trades are settled earlier than weekly settlements and reduce settlement risk. Since trades of a particular day are settled distinctly from other days’ transactions in rolling settlements, the settlement position
is spread over various days that reduce the settlement risk. Because of this the seller and buyers get money and securities on time for their sale and purchase transactions

2.4.7 Emergence of New Mutual Funds

Mutual funds have seen a major growth during 1990s Though initially UTI had the monopoly, the amendment of the Banking Regulations Act during 1987, permitted public sector banks, commercial banks, and financial institutions to set up mutual funds Government of India subsequently allowed the private sector companies and foreign mutual funds either through joint venture with Indian firms or on their own to enter into the mutual fund industry in the year 1993 As per union budget 2002-03 mutual funds were permitted to make investment in foreign debt securities including government securities in the countries with fully convertible currencies and with the highest rating This brought severe competition among mutual funds. The mutual funds have recorded tremendous growth since 1990s. The cumulative funds mobilised was Rs 85,822 crore in 1997 In the year 2002 it was Rs 1,64,523 crore and rose to Rs 5,90,189 crore in 2004

However, the UTI scam has reduced public confidence on mutual funds Therefore, to enhance investors’ confidence in mutual funds SEBI issued guidelines to mutual funds related to accounting policies, calculation of Net Asset Value (NAV), initial issue expenses, pricing of units, disclose performance in terms of rise/fall in NAV, yield, investment made in associated companies, details of large holdings, half-yearly results, portfolios, etc In addition to these, in the year 2003-04 SEBI reviewed and amended SEBI (Mutual Funds) (Amendment) Regulations, 2003 to protect investors’ interest During the year 2003-04 opportunities for investing have been widened for mutual funds by allowing them to invest up to 10 percent of the net assets as on January 31 of each year in foreign securities with the minimum limit of US $ 5 million and maximum of US $ 50 million

2.4.8 Demutualisation and Corporatisation of the Stock Exchanges

The finance minister on March 2001 announced that the stock exchanges would be corporatised by which ownership, management and trading membership would be segregated from each other and that administrative steps will be taken and legislative changes, if required, will be proposed accordingly It is the process of converting the organisational structure of the stock exchange from a non-corporate
structure to a corporate structure. Demutualisation refers to the process of converting an exchange from a “mutually-owned” association to a company “owned by shareholders.” In accordance with the government policy, the SEBI Board decided that henceforth no stock broker member of any stock exchange shall be an office bearer of the exchanges i.e. hold the position of president, vice-president, treasurer etc. All recognised stock exchanges were also directed to amend their rules, articles, etc. SEBI under the chairmanship of Justice M.H. Kania, former Chief Justice of India, constituted a ‘committee on corporatisation and demutualisation of stock exchanges’ and to recommend the steps that required to be taken to implement the same. The committee had submitted its report to SEBI on August 28, 2002 and SEBI accepted all the recommendations of Kania committee except that in the case of NSE, the present structure of its board would be maintained and the voting rights of the shares held by the broker members would be determined by SEBI in consultation with the government of India. The government of India in the month of October 2004 promulgated an ordinance to amend the Securities Contracts (Regulation) Act (SCRA) in an attempt to remove legal hurdles to facilitate demutualisation and corporatisation of stock exchanges. Currently, two stock exchanges in India, the National Stock Exchange (NSE) and Over the Counter Exchange of India (OTCEI) are not only corporatised but also demutualised with segregation of ownership and trading rights of members.

In a process of making Indian stock market more competitive, fair, transparent and efficient, SEBI has brought in many other reforms and new regulations.

The advocates of efficient market hypothesis assume that the market is not only informationally efficient but also operationally efficient. It is the speed of supply of information and investors’ confidence in the pricing mechanism that makes the market efficient. Accordingly, the above reforms and developments initiated in the Indian stock market to make it efficient, transparent, and free from manipulations, price rigging, violations, etc., make on a par with other developed stock markets of the world. These and several other reforms and developments will go a long way in the direction of restoration of investors’ confidence in the Indian stock market. However, much depends upon the efficiency and effectiveness in implementing these reforms.