CHAPTER III

INDIAN STOCK MARKET - THE PRESENT SCENARIO

3.1 Introduction

Capital market is the centre or arrangement that provides facilities for buying and selling of long-term financial claims. It is the market where transactions are made in long-term securities such as stocks and bonds. The participants of this market includes various financial institutions, mutual funds, agents, brokers, dealers and other borrowers and lenders of long term debt and equity capital.

Capital market is not a compact unit but consists of two major parts:

- Primary Market
- Secondary market.

The primary market or otherwise called as new issue market is one in which long term capital is raised by corporate directly from the public. The secondary market or popularly called as the stock market refers to the market where these long-term financial instruments which are already issued in the primary market are traded.

The initial emergence of stock markets in the world can be traced back over hundreds of years to when industrialization and innovation took hold in Europe. The rapid economic growth in the past one hundred years gave rise to the explosive development of stock markets. At the same time the enhancement of stock markets has played an important role in promoting the growth of the world
economy. The modern market economy depends to a greater extent on a soundly operated stock market.

Stock market provides liquidity to the financial instruments which are issued in the primary market. Players in the capital market are broadly divided into three categories:

- **Companies issuing securities** and includes new companies, existing unlisted companies and the existing listed companies.

- **Intermediaries** who assist in the process of transferring savings into investment and they include merchant bankers, underwriters, registrars to issue and share transfer agents, brokers, depositories, collecting agents, advertising agencies, agents, mutual funds etc.

- **Investors** consisting of institutional investors and the general public.

Capital market consists of equity market as well as debt market. But the chapter will be focusing on equity market as it is more relevant for this study.

### 3.2 Trading in Indian Stock Market

Stock markets refer to a market place where investors can buy and sell stocks. The price at which each buying and selling transaction takes place is determined by the market forces. The Indian secondary capital market or the stock market mainly consists of the stock exchanges, Over the Counter Exchange of India and Stock Holding Corporation of India. Indian stock market can be quoted as one of oldest stock markets in Asia which is almost 200 years old.
Stock Holding Corporation of India Ltd was incorporated in 1986 as a public limited company. It has been jointly promoted and owned by the All India Banks and Financial Institutions, viz., IDBI Bank Ltd, ICICI Bank, Axis bank, IFCI Ltd, LIC, GIC, NIA, NIC, UIC, and TOICL, who are all leaders in their fields of business. SHCIL has been established as a one stop provider of all financial services. It began its operations by offering custodial and post-trading services and later added depository and other services to its business portfolio.

Stock exchange represents an organized market in trading of securities. The organized stock exchanges in India are of recent origin when compared with other financial markets. The first stock exchange was set up in India under the name of Native share and Stock Broker’s Association of Bombay (now, Bombay Stock Exchange) in 1875. At the end of March 2009, there were 20 stock exchanges registered with SEBI (Securities Exchange Board of India) having a total of 8,652 registered brokers and 62,471 registered sub-brokers trading on them.

The stock exchanges need to be recognized under the Securities Contracts (Regulation) Act 1956. As of now SEBI has approved and notified the Corporatisation and Demutualisation scheme of 20 stock exchanges.
Table 3.1
Capital Market Turnover on Stock Exchanges in India

<table>
<thead>
<tr>
<th>Stock Exchanges</th>
<th>Capital Market Turnover (Rs. million)</th>
<th>Share in Turnover (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007-08</td>
<td>2008-09</td>
</tr>
<tr>
<td>1 NSE</td>
<td>35,510,380</td>
<td>27,520,230</td>
</tr>
<tr>
<td>2 BSE</td>
<td>15,788,570</td>
<td>11,000,740</td>
</tr>
<tr>
<td>3 Calcutta</td>
<td>4,460</td>
<td>3,930</td>
</tr>
<tr>
<td>4 Uttar Pradesh</td>
<td>4,750</td>
<td>890</td>
</tr>
<tr>
<td>5 Ahmedabad</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>6 Delhi</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>7 Pune</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>8 Ludhiana</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>9 Bangalore</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>10 ICSE</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>11 Madras</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>12 Madhya Pradesh</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>13 Vadodara</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>14 OTCEI</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>15 Gauhati</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>16 Cochin</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>17 Bhubaneshwar</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>18 Coimbatore</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>19 Jaipur</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>51,308,160</td>
<td>38,525,790</td>
</tr>
</tbody>
</table>

*Source: www.nseindia.com*
From the table (Table 1) it is very evident that NSE and BSE were the only two stock exchanges which reported significant trading volumes during the last 3 financial years. Other than Calcutta and Uttar Pradesh Stock exchanges all other exchanges did not have any trading volumes during 2008-09 and 2009-10 (April-June). National Stock exchange (NSE) consolidated its position as the market leader with 71.43% of the total trading volume.

The trading platform of a stock exchange is accessible only to trading members. The brokers would give buy/sell orders either own their own account or for their clients. The exchange can admit a broker as its member only on the basis of terms specified by Securities Contract (Regulation) Act, 1956, the SEBI Act 1992, and other rules and regulations of concerned exchange also. Certificate of registration from SEBI is compulsory for trading in securities.

Listing is the formal admission process of a security in to the trading platform of a stock exchange. Listing of securities India is governed by the provisions in the following acts:

a) Companies Act, 1956

b) Securities Contracts (Regulation ) Act, 1956

c) Securities Contracts (Regulation) Rules ,1957

d) Circulars/guidelines issued by Central Government and SEBI

e) Rules and Regulations of concerned stock exchanges.
The stock exchanges levy listing fees on the companies, whose securities are listed with them. Fee structure has two basic components: Initial Fee and Annual Fee.

Initial fee is a fixed amount for all the companies as decided by SEBI and stock exchanges while annual fee varies depending upon the size of the company. As per SEBI provisions, the basic norms for listing of securities should be uniform for all stock exchanges in the country.

3.3 Stock Market Indicators

Rise or fall of share prices on a particular trading day depends on many factors. The success of an investor in the stock market always depends on how well he is able to incorporate all these factors while taking up his investment decisions. Stock market indicators are extremely used by investors across the world while taking various buy or sell decisions in the market. Any indicator which is used to project future financial and economic trends can be called as market indicators. The following are some of the popular stock market indicators used by Indian Investors:

a) Market Capitalisation: It refers to the total value of all outstanding shares which is found out by multiplying the number of shares by the current market price. The market capitalization to GDP ratio is another parameter for evaluation of stock markets. Liquidity of the market can be measured by comparing the traded value to GDP ratio i.e value of the shares traded to GDP at current market prices.
b) Price to earnings ratio (P/E ratio): It refers to a valuation of a firm’s current share price compared to its earnings per share (EPS). Usually EPS is calculated by using the previous four quarters. A high P/E indicates significant projected earnings in future.

c) Return on Equity (ROE): Investment in company’s equity being compared with the return on equity. It is a measure of company’s profitability compared with other firms in the same industry.

d) Dividend Yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price. It is calculated by dividing annual dividend per share by price per share.

e) Price to book value: It refers to the process of comparing a stocks market value to its book value. A low price to book value would be either because the stock is undervalued or it could mean that the company is not in the best of health.

3.4 Index Services

A stock index consists of a set of stocks that are representative of either the whole market or a specified sector. It helps to measure the change in overall behaviour of the market on sector over a period of time. NSE and CRISIL in technical partnership with Standard & Poor have jointly promoted the Index Service & Products Limited (IISL). It is the only specialised organization of this type in the country. IISL maintains number of equity indices comprising of broad-based benchmark indices, sectoral indices and customised indices.
Table 3.2
Major Indices of Indian Stock Market

<table>
<thead>
<tr>
<th>Indices</th>
<th>2007-08</th>
<th>2008-09</th>
<th>Percentage variation over the previous Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>2007-08</td>
</tr>
<tr>
<td>BSE Sensex</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year end</td>
<td>15644</td>
<td>9709</td>
<td>19.68</td>
</tr>
<tr>
<td>Average</td>
<td>16569</td>
<td>12366</td>
<td>35.00</td>
</tr>
<tr>
<td>S &amp; P CNX Nifty</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year end</td>
<td>4735</td>
<td>3021</td>
<td>23.89</td>
</tr>
<tr>
<td>Average</td>
<td>4897</td>
<td>3731</td>
<td>37.08</td>
</tr>
<tr>
<td>S &amp; P CNX 500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year end</td>
<td>3826</td>
<td>2295</td>
<td>21.64</td>
</tr>
<tr>
<td>Average</td>
<td>4097</td>
<td>2951</td>
<td>37.85</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report 2008-09

The economic slowdown of advanced countries which started as a result of sub-prime crisis in USA in mid 2007 has also affected economies around the globe. At the peak of financial crisis, Indian stock market (Sensex) crashed from high of 20000 to a low of around 8000 points (Fig.3.1). All the indices of the country showed a negative return during this time frame (Table 3.2). Tumbling of Indian stock market was mainly because of drying up of overseas financing, constraints in raising funds in bearish domestic market and also due to decline in the internal accruals of corporates.
Volatility in Stock Markets

Volatility is basically the variation from the average value over a measurement period. If a price of a security varies a great deal from day to day, the volatility of it will be high, and conversely if the day to day variation is low, the value of volatility will be low as well. It is measured by the standard deviation of logarithmic returns during a certain period.

In the financial year 2008-09 stock markets across the globe witnessed extreme volatility. In India Sensex soared to 43.6 percent in 2008-09 from 30.6 percent in 2007-08. Similar trend was observed for other indices also.

Over the years it has been observed that the correlation between Indian Stock Market\textsuperscript{1} and other world markets are on an increasing trend. This phenomenon should explain the reason for increased volatility exhibited by...
Indian markets during 2008-09 periods. When world markets move the valuation of Indian stocks are also affected.

3.6 Review of Recent Policy developments and Programmes

SEBI along with other regulators and government have initiated number of policies and programmes during the financial year 2008-09 in order to improve the efficiency of operations in capital market. Basically these measures are aimed at protecting the interests of the investors. Major policy developments pertaining to capital market are enumerated below.

a) Shareholding in stock exchanges: To encourage competition in the stock exchange space, SEBI board decided to enhance the shareholding in the stock exchanges from 5 percent to 15 percent in respect of six categories of share holders namely, public financial institutions, stock exchanges, depositories, clearing corporations, banks and insurance companies as on December 23, 2008.

b) Securities Lending and Borrowing (SLB): In pursuant of the feedback from the market participants, the Securities Lending and Borrowing scheme was revised with effect from April 21, 2008. Key modifications include increasing the tenure of SLB, extending the duration of SLB sessions and allowing margins in SLB. The securities lending and borrowing scheme has the potential of taking the Indian stock market to great heights. But unfortunately this scheme till now has not been able to show its presence in the market to its fullest.
c) **Guidelines in respect of exit option to Regional Stock Exchanges:**

Broad guidelines were issued by SEBI with the objective of providing an exit option to Regional stock exchanges (RSEs) whose recognition was withdrawn or if renewal of recognition was refused by SEBI or for RSEs who would like to surrender their recognition. As per the SEBI guidelines such RSEs may be permitted to retain movable and immovable assets and to deal with such assets as they deem fit, subject to the compliance with SEBI norms in this regard.

d) **Introduction of Direct Market Access (DMA):** Direct Market Access allows brokers to offer his clients access to the exchange trading systems through broker’s infrastructure without manual intervention by the broker. SEBI introduced DMA with a view to increase liquidity, to have more transparent trading and to reduce the risk of error associated with manual execution of client orders.

e) **Margining of Institutional Trades in the Cash Market:**

Margining for institutional trades was made mandatory by SEBI w.e.f April 21; 2008. This initiative by SEBI was to strengthen the risk management framework in capital market operations. Margins have to be collected from institutional investors on a T + 1 basis and the institutional investors can maintain the entire margin in the form of approved securities.
f) **Mandatory Permanent Account Number (PAN) Requirement:**
SEBI exempted investors residing in the state of Sikkim from the mandatory requirement of PAN for their investments in mutual funds.

g) **Advertisement by Mutual Funds:** Investments in mutual funds are subject to market risk and an investor has to read the entire offer document before going for such investments. Hence it was made mandatory by SEBI that such statement i.e statements appearing in clauses of 10, 13 and 14 of schedule VI of SEBI (Mutual Fund) Regulations 1996, on advertisement code should appear in all advertisements. However with effect from January 18, 2010 such advertisement should be printed in bold .This was because these statements were not often brought to the notice of investors due to the lengthy nature of mutual fund advertisements.

h) **Application supported by blocked amount (ASBA) facility in public issues and right issues:** In its endeavor to make the existing public issue facility more efficient SEBI has introduced the ASBA facility as on July 30th 2008.Such facility is made available to retail investors also. ASBA is an application containing an authorization to block the application money in the bank account, for subscribing to an issue. If an investor is applying through ASBA, his application money shall be debited from the bank account only, if his/her application is selected for allotment.
i) Quarterly Reporting by Foreign Venture Capital Investors (FVCI):

With effect from the quarter that ended in 31st March 2010, all FVCI operating in India have to submit quarterly reports with SEBI. The report is to be uploaded in the SEBI portal within 7 days from the end of each calendar quarter. This measure can be looked upon as one taken for bringing more transparency in the operations of FVCI.

Indian markets had recorded severe volatility at the close of 2007-08. However towards the beginning of 2008-09 the market started recovering and registered gains during April –May 2008. One of the major reason for such speedy recovery was due to the timely regulations and policies introduced by various market regulators.

3.7 National Stock Exchange of India (NSE)

The NSE is one of the few exchanges in the world trading all types of securities on a single platform. Its operations are divided into three segments:

- Wholesale Debt Market (WDM)
- Capital Market (CM)
- Futures & Options (F&O) Market

The Wholesale Debt Market (WDM) segment of NSE deals in fixed income securities. It commenced its operations on June 30th 1994. WDM provides trading facilities for various debt instruments like Government Securities, Treasury Bills and Bonds issued by Public Sector Undertakings/ Corporates/ Banks, like Floating Rate Bonds, Zero Coupon Bonds,
Commercial Papers, Certificate of Deposits, Corporate Debentures, State Government loans, SLR and Non-SLR Bonds issued by Financial Institutions, Units of Mutual Funds and Securitized debt by banks, financial institutions, corporate bodies, trusts and others.

NSE started trading in the Capital Market segment or equities segment on November 3, 1994 and within a short span of one year NSE became the largest exchange in India in terms of volumes transacted.

Trading in derivatives was started by the exchange with the launch of index futures on June 12, 2000. The Exchange introduced trading in Index Options on June 4, 2001. NSE also became the first exchange to launch trading in options on individual securities from July 2, 2001. Futures on individual securities were introduced on November 9, 2001. Futures and Options on individual securities are available on 190 securities stipulated by SEBI.

Each segment has experienced a significant growth over a few years of their launch. While the WDM segment has accumulated the annual growth of over 40 percent since its opening in 1994, the CM segment has increased by more than 60 percent during the same period.

3.8 Trading Mechanism in National Stock Exchange

NSE is the first stock exchange to be set up in the country having nation-wide access with fully automated screen based trading system. It has become the largest exchange in India as on 2008-09 results with more than 70
percent of the trading volumes on it. It can be quoted as one of very few exchanges in the world which has adopted anonymous order matching system.

Trading system of NSE is National Exchange for Automated Trading (NEAT). NEAT facilitates an on-line system which is fully automated and provides nationwide, anonymous, order driven, screen based trading. The advantages of this system include:

a) Improved operational efficiency by minimizing risk of error and fraud.

b) Increased informational efficiency as it allows faster incorporation of price sensitive information.

c) Improving the liquidity of the market by making market transparent.

d) User friendly and suitable for retail investors as well as institutional investors.

e) Faster settlement of disputes by logging in to the trade execution process.

f) Trading platform in capital market segment is accessible from computer terminals of brokers as well as from the personal computers of individual investors.

At the end of March 2009, a total number of 349 members were permitted to allow investor’s web based access to NSE’s trading system.

3.9 NSE Indices

A stock market index is a number that measures the relative value of a group of stocks. As the stocks in this group change value, the index also
changes its value. If an index goes up by 1 percent then that means the total value of the securities which made up the index have gone up by 1 percent in value.

An index is created by selecting a group of stocks that are representative of the whole market or a specified sector. It is calculated with reference to a base period and a base index value.

Some of the benefits of these stock market indices include:

a) Facilitate comparison of returns on investments in stock market against other investment options available in the market.

b) For establishing standards against which the performance of individual scrip or equity fund is compared.

c) Can act as an overall indicator of the state of economy

d) Helps in implementation of appropriate risk management strategies for the various investments.
The following are some of the major indices of NSE India Ltd.

Table 3.3

<table>
<thead>
<tr>
<th>Indices</th>
<th>Particulars</th>
<th>Base date of the Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>S &amp; P CNX Nifty(Nifty 50)</td>
<td>Blue chip index of NSE which is most popular and widely used stock market indicator of the country. It consists of diversified 50 stocks index accounting for 22 sectors of the economy. Nifty 50 accounts for more than 60 percent of total market capitalisation of capital market segment of NSE as on March 2009.</td>
<td>November 3rd, 1995</td>
</tr>
<tr>
<td>CNX Nifty Junior</td>
<td>This index consists of the next most liquid securities after Nifty 50. This index accounts for more than 9.5 percent of market capitalisation of capital market segment of NSE as on March 2009.</td>
<td>November 3rd, 1996</td>
</tr>
<tr>
<td>CNX 100</td>
<td>This consists of diversified 100 stocks representing 35 sectors of the economy. Index is a combination of the Nifty 50 and CNX Nifty Junior.</td>
<td>January 1st, 2003</td>
</tr>
<tr>
<td>S &amp; P CNX 500</td>
<td>This is India’s first broad based benchmark of the Indian capital market and helps in comparing portfolio returns and market returns. It represents about 95.11 percent of total market capitalization and about 90 percent of the total turnover on the NSE as on March 31st, 2009.</td>
<td>1994</td>
</tr>
<tr>
<td>Nifty Midcap</td>
<td>The primary objective is to trace the movement of the midcap segment which a market segment with high growth potential.</td>
<td>January 1st, 2004</td>
</tr>
<tr>
<td>CNX Midcap</td>
<td>The primary objective is to trace the movement of the midcap segment which a market segment with high growth potential.</td>
<td>January 1st, 2003</td>
</tr>
<tr>
<td>S &amp; P CNX Defty</td>
<td>S &amp; P CNX Defty is Nifty 50 measured in dollars which is used as an instrument for measuring returns of institutional investor and off-shore fund enterprise with an equity exposure in India.</td>
<td>November 3rd, 1995</td>
</tr>
</tbody>
</table>

Source: www.nseindia.com
3.10 International Equity Market Integration

The Indian stock market is one of the earliest in Asia, being in operation since 1875, but it remained largely outside the global integration process until the late 1980s. Globalization, economic assimilation and liberalization in the country have promoted the growth of international financial integration in the country.

Major factors contributing to financial integration and equity market integration in India are:

a) Growth of multinational corporations and organisations
b) Advancement in the field of Information Technology
c) Greater deregulations in the Indian financial system
d) Growth in International Capital flows
e) More liberal foreign exchange policy of the country.

Perfectly integrated markets operate as one entity, with investors facing a common set of risks. Pricing in such markets also would be in the similar way. Evidence suggests that developed countries have gained most from capital market integration to date, and any further integration will mainly benefit emerging markets. So the scope equity market integration in India in the next few years is tremendous. Integration with other International capital markets has advantages and disadvantages. Potential benefits from integration include:

a) Better allocation of Capital
b) Adoption of efficient risk management strategies
c) Portfolio diversification
d) Presence of a better competitive environment

e) Lower cost of Capital

In spite of all these benefits there are certain risks which arise because of this integration. Integration not only encourages inflows but also outflows of capital, with potentially adverse consequences for the domestic economy. Moreover increased correlations between international markets indicate that benefits of international diversification diminish after an unexpected exogenous event. This can be very well understood by studying the impacts of recent financial crisis.

Over the past ten years Indian Stock Market has witnessed many changes which are in line with the economic development of the country. Trading and settlement procedures have been improved and many new instruments have been introduced with an objective of meeting the varied preferences and risk appetite of Indian investors. Disclosure levels have been enhanced and market transparency has improved. Measures to protect investors’ interest have also attained greater importance during the last few years.

Lots of investor education programs are also been initiated by market regulators with a view to encourage more and more capital market activities in the country. A code of corporate governance has been put in place and steps were taken to change the organizational structure of the stock exchanges.

Considering all these factors along with the current economic development of the country, growth of Indian Stock would be tremendous in the coming years. However the market has to become further transparent and reliable
with lesser volatility to attract more and more foreign capital inflows into the country.

**End Note**

1 While an attempt has been made to present market design for the entire Indian securities market, the trading mechanism and such other exchange specific elements have been explained based on the model adopted by NSE. The market developments have been explained, mostly for the two largest stock exchanges namely National Stock Exchange and Bombay Stock Exchange. Wherever data permitted, an all India data has been presented.