CHAPTER - III

CAPITAL MARKETS IN INDIA

The pace of economic development is conditioned, among other things by the rate of long-term investment and capital formation. Capital formation is conditioned by the mobilization, augmentation and channelization of investible funds. The capital market serves a very useful purpose by pooling the capital resources of the country and making them available to the enterprising investors. Well developed capital markets augment resources by attracting and lending funds on global scale[1].

The increase in the size of the industrial units and business corporations due to technological developments, economies of scale and other factors has created a situation wherein the capital at the disposal of one or few individuals is quite insufficient to meet the growing investment demands. A developed capital market can solve this problem of paucity of funds. An organized capital market can mobilize and pool together even the small and scattered savings and augment the availability of investible funds[2]. While the rapid growth of joint stock companies has been made possible to a large extent by the growth of capital markets, the growth of joint stock business has in turn, encouraged the development of capital markets.

The Concept of Capital Market

It is an organized market mechanism for effective and efficient transfer of money capital or financial resources from the investing class (a body of individual or institutional savers) to the entrepreneur class (individual or institutions engaged in industry business or service) in the private and public sectors of the economy.

In a very broad sense, it includes the market for both long-term and short-term funds. H.T. Parikh has referred to it as, “By capital market, I mean the market for all the financial instruments, short-term and long - term as also commercial, industrial and government paper.”

In the words of Goldsmith, “the capital market of a modern economy has two basic functions: first the allocation of savings among users and investment; second the facilitation of the transfer of existing assets, tangible and intangible among individual economic units[3]”

Grant defines capital market in a broad sense as “a series of channels through which the savings of the community are made available for industrial and commercial enterprises and for public authorities. It embraces not only the system by which the public takes up long-term securities directly or through intermediaries but also the elaborate network of institutions responsible for short – term and medium – term lending.”

From the above definitions, it may be deducted that the function of capital market is the collection of savings and their distribution for industrial investment. Thus, capital formation is sine qua non of economic development. As such, the relationship between the market, instrument, and services are integrated as well as inter-dependent.

Capital market is generally understood as the market for long – term funds. The capital market provides long-term debt and equity[4] finance for the government and the corporate sector. By making long – term investments liquid, the capital market mediates between the conflicting maturities preferences of lenders and borrowers. The Capital market also facilitates the dispersion of business ownership and the reallocation of financial resources among corporations and industries.

Capital Market Structure in India

An important segment of the organized financial system comprises of the new issues market and stock market. The term capital market is a wide term, encompassing all long-term claims of money–lending and borrowings. It thus includes all term lending by banks and financial institutions and long-term borrowings from foreign markets and new issues by companies and raising of all resources from public through issue of new securities, deposits, loans etc.

Capital market includes issues of two major categories – marketable and non – marketable, whether marketable or not, these are issued by government and government departments, companies, public sector units, mutual funds, UTI etc., LIC and GIC sell policies and collects savings from public, which are not marketable. The other non-marketable securities or claims are issued by post offices as savings certificates, deposit receipts etc., non-securitized loans and advances of banks and financial institutions, deposits with banks and companies and securities of private limited companies and finance company deposits / loans, chit funds etc., the marketable securities are issued through the new issues market and are traded through the stock market.

The contributors to new issues are promoters, collaborators, if any, employees, NRIs, banks, FIIs, Mutual Funds[5] and the public at large. The players through whom these issues are managed are mainly merchant bankers, registrars, brokers, mutual funds, etc., which are dealt with in detail in later chapters. The ancillary function and complementary to the above is those of underwriters, collecting bankers, investment consultants, portfolio managers, investment managers etc., are also discussed in later chapters.

The capital market study should authentically encompass both the marketable and non-marketable segments. In view of the fact that demand and supply forces and trading activity is confined only to the segment of marketable securities, this book is using the term 'Capital Market' in the sense of marketable securities[6]. Thus, more popular instruments traded in the market are equities, debentures, and bonds etc., which are discussed in this book. UTI and the mutual fund schemes being popular for trading, they are also dealt with. Briefly the major players–instruments and activities in capital market are covered from the point of management.

Constituents of Capital Market

The constituents of the Capital market comprise of development banks, specialized financial institutions, investment institutions, state level development banks, mutual funds, lease companies, financial service companies, commercial banks[7] and other specialized institutions were set up by development banks for the growth of the capital market, notably, SEBI, SHCIL, CRISIL, IICRA, AMC, OTCEI and the National Stock Exchange.

Dimensions of Capital Market

The Capital market is directly responsible of the following actiities : (1) Mobilization or concentration of national savings for economic development, (2) Mobilization and import of foreign capital and foreign investment capital plus skill to fill up the deficit in the required financial resources to maintain the expected rate of economic growth, (3) Productive utilization of resources, and (4) Directing the flow to funds of high yields and also strive for balanced and diversified industrialization.

A nation embarking upon accelerated economic development and industrialization[8] has to make planned efforts to develop organized and healthy money and capital markets with an adequate institutional set-up, Market for credit (money and capital market) and business enterprises[9] must go hand-in-hand to ensure quick industrialization in a developing democratic country.

History of the Capital Market

The history of the capital market in India dates back to the eighteenth century when East India Company securities were traded in the country. Until the end of the nineteenth century, securities' trading[10] was unorganized and the main trading centers were Bombay (now Mumbai) and Calcutta (now Kolkata). Of the two, Bombay was the chief trading center wherein bank shares were the major trading stock. During the American Civil War (1860-61), Bombay was an important source of supply for cotton.

Hence, trading activities flourished during the period, resulting in a boom in share prices. This boom, the first in the history of the Indian capital market, lasted for a half a decade. The bubble burst on July1, 1865, when there was tremendous slump in share prices.

Trading was at that time limited in a dozen brokers; their trading place was under a banyan tree in front of the Town Hall in Bombay. These stock brokers organized an informal association in 1875-Native Shares and Stock Broken Association, Bombay. The stock exchanges in Calcutta and Ahmadabad, also industrial and trading centers, came up later the Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925.

The capital market was not well organized and developed during the British rule because the British government was not interested in the economic growth of the country. As a result, many foreign companies depended on the London capital market for funds rather than on the Indian capital market.

In the post – independence period also, the size of the capital market remained small. During the first and second five year plans, the government's emphasis was on the development of the agricultural sector and public sector undertakings. The public sector undertakings were healthier than the private undertakings in term of paid – up capital but their shares were not listed on the stock exchanges. Moreover, the Controller of Capital Issues (CCI) closely supervised and controlled the timing, composition, Interest rates, pricing, allotment, and floatation costs of new issues. These strict regulations de motivated many companies from going public for almost four and a half decades.

As speculation became rampant, the stock market[11] came to be known as 'Satta Bazaar'. Despite speculation, non-payment or defaults were not very frequent. The government enacted the securities Contracts (Regulation) Act in 1956 to regulate stock markets. The Companies Act, 1956 was also enacted. The decade of the 1950s was also characterized by the establishment of a network for the development of financial institutions and state financial corporations.

The 1960s was characterized by wars and droughts in the country which led to bearish trends. These trends were aggravated by the ban in 1969 on forward trading and 'Badla', technically called 'contracts for clearing'. 'Badla' provided a mechanism for carrying forward positions as well as for borrowing funds. Financial institutions such as LIC and GIC helped to revive the sentiment by emerging as the most important group of investors. The first mutual fund of India, the Unit Trust of India (UTI) came into existence in 1964. In the 1970s, badla trading was resumed under the disguised form of 'hand-delivery contracts – A group.' This revived the market. However, the capital market received another server setback on July 6, 1974, when the government promulgated the Dividend Restriction Ordinance[12], restricting the payment of dividend by companies to 12 per cent of the face value or one-third of the profits of the companies that can be distributed as computed under section 369 of the Companies Act, whichever was lower. This led to a slump in market capitalization at the BSE by about 20 per cent overnight and the stock market did not open for nearly a fortnight. Later buoyancy came in the stock markets when the multinational companies (MNCs) were forced to dilute their majority stocks in their ventures in favour of the Indian public under FERA, 1973. Several MNCs opted out of India. One hundred and twenty three MNCs offered shares worth Rs.150 crore, creating 1.8 million share holders within four years. The offer prices of FERA shares are lower than their intrinsic worth. Hence, for the first time, the FERA dilution created an equity cult in India. It was the spate of FERA issues that gave a real fillip to the Indian stock markets. For the first time, many investors got an opportunity to invest in the stocks of such MNCs as Colgate, Hindustan Lever Limited. Then, in 1977, a little known entrepreneur, Dhirubhai Ambani, tapped the capital market. The scrip, Reliance Textiles, is still a hot favourite and dominates trading at all stock exchanges[13].

The 1980s witnessed an explosive growth of the securities market in India, with millions of investors suddenly discovering lucrative opportunities. Many investors jumped into the stock markets for the first time. The government's liberalization process initiated during the mid-1980s, spurred this growth. Participation by small investors, speculation, defaults, ban on badla, and resumption of badla is continued. Convertible debentures emerged as popular instrument of resource mobilization in the primary market. The introduction of public sector bonds and the successful mega issues of Reliance Petrochemicals and Larsen and Toubro gave a new lease of life to the primary market. This, in turn, enlarged volumes in the secondary market. The decade of the 1980s was characterized by an increase in the number of stock exchanges, listed companies, paid up capital, and market capitalization.

The 1990s will go down as most important decade in the history of the capital market of India. Liberalization and globalization were the new terms coined and marketed during this decade. The capital issues (control) Act, 1947 was repealed in May 1992. The decade was characterized by a new industrial policy[14], emergence of SEBI as a regulator of capital market, advent of foreign institutional investors, euro issues, free pricing, new trading practices, new stock exchanges, entry of new players such as private sector mutual funds and private sector banks, and primary market boom and bust.

Major capital market scams took place in the 1990s. These shook the capital market and drove away small investors from the market. The securities scam of March 1992 involving brokers as well as bankers was one of the biggest scams in the history of the capital market. In the subsequent years owing to free pricing, many unscrupulous promoters, who raised money from and capital market, proved to be fly-by-night operators. This led to erosion in the investor's confidence. The M.S Shoe case, one such scam which took place in March 1995, put a break on new issue activity.

In 1991-92 securities scam revealed the inadequacies of and inefficiencies in the financial system. It was the scam, which prompted a reform of the equity market. The Indian Stock Market witnessed a sea change in term of technology and market prices. Technology brought radical changes in the trading mechanism. The Bombay Stock Exchange was subject to nationwide competition by two new stock exchanges- the National Stock Exchange[15], set up in 1994, and Over the Counter Exchange of India, set up in 1992. The National Securities Clearing Corporation (NSCC) and National Securities Depository Limited (NSDL) were set up in April 1995 and November 1996 respectively for improved clearing and settlement and dematerialized trading. The securities Contracts (Regulation) Act, 1956 was amended in 1995-96 for introduction of options trading. Moreover, rolling settlement was introduced in January 1998 for the dematerialized segment of all companies, with automation and geographical spread, stock market participation increased.

In the late 1990s, the Information Technology (IT) scrip's were dominant on the Indian Bourses; these scrip's included Infosys, Wipro, and Satyam. They were a part of favorite scrip's of the period, also known as 'New Economy' scrip's, along with telecommunications and media scrip's. The new economy companies are knowledge intensive unlike the old economy companies that were asset intensive.

The Indian capital market entered the twenty-first century[16] with Ketan Parek scam. As a result of the scam, badla was discontinued from July 2001 and rolling settlement wad introduced in all scrips. Trading at futures commenced from June 2000, and Internet trading was permitted in February 2000. The government's decision to privatize oil PSUs and in 2003 fuelled stock prices. One big divestment of international telephony major VSNL took place in early February 2002. Foreign institutional investors have emerged as major players on the Indian bourses. NSE has an upper hand over its rival BSE in terms of volumes not only in the equity markets but also in the derivatives market.

It has been a long journey for the Indian capital market. Now the capital market is organized, fairly integrated, mature, more global and modernized. The Indian equity market is one of the best in the world is terms of technology. Advances in computer and communications technology, coming together on Internet are shattering geographic boundaries and enlarging the investor class. Internet trading had become a global phenomenon. The Indian stock markets are now getting integrated with global markets.

Table No: 3.1 A brief history of the rise of equity trading in India

Year	Particulars
July 9, 1875	Native brokers from the native share and stock Brokers' association in Bombay. Membership fee is Re. 1. The association has 318 members.
1899	Bombay Stock Exchange acquires own premises.
1921	Clearing houses are established for settlement of trades as volumes increase.
1923	K R P Shroff becomes the honorary president of BSE.
1925	Bombay Securities Contract Control Act (BSCCA) comes into force.
December 1, 1939	Stock exchange building is acquired.
1943	Forward trading banned till 1946. Only ready to deliver and hand delivery contracts permitted.
1956	Securities Contract Regulation Act drafted on the lines of BSCCA comes into force.
1957	BSE becomes the first exchange in India to get permanent recognition.
1964	Unit Trust of India (UTI) is born.
April 1, 1966	K R Pshroff retires and Phiroze J Jeejeebhoy becomes chairman.
June 29, 1969	Morarji Desai bans forward trading.
1973	Construction of P J Towers, names after late Phiroze Jamshedji Jeejeebhoy, starts.
January 2, 1986	BSE Sensex launched as the first stock market index with 1978-79 as the base year.
November, 1987	SBI Mutual Fund launches Magnum Regular Income Scheme.
April, 1988	Securities and Exchange Board of India (SEBI) set up.
January, 1992	SEBI is given statutory powers.
May, 1992	Harshad Mehta securities scam breaks.

May 27, 1992	Reliance is the first Indian company to make a GDR issue.
May 30, 1992	The Capital issues Control Act, 1947 is repeated.
September, 1992	Foreign institutional investors are permitted to invest in the Indian securities market.
November, 1992	Finance Minister Manmohan Singh inaugurates Over the Counter Exchange of India.
October 30, 1993	The first private sector mutual fund, Kothari Pioneer Mutual Fund, begins operations.
1993	SEBI bans badla trading on BSE.
January, 1994	NSE commences operations in wholesale debt market segment.
November, 1994	The capital market segment of NSE goes on stream. Trading is screen based for the first time in India.
March, 1995	BSE on line trading system (BOLT) replaces open outcry system.
April, 1995	The National Securities Clearing Corporation Limited, India's first clearing corporation is set up.
October, 1995	NSE overtakes BSE as the largest stock exchange in terms of volume of trading.
April, 1996	Nifty is born. The National Securities Clearing Corporation Limited commences operations.
November, 1996	The National Securities Depository Limited is created.
February, 1997	SEBI releases norms for takeovers and acquisitions.
May, 1997	BSE introduces screen based trading.
November, 1998	SEBI recognizes Interconnected Stock Exchange founded by 15 regional stock exchanges. This exchange starts functioning in February 1999.
February, 98	Launch of automated lending and borrowing mechanism (ALBM) on NSE.
March 11, 1999	Infosys Technologies is the first company to be listed on NASDAQ through a public offering of American Depository Receipts.

March 22, 1999	Central Depository Services (India) promoted by BSE commences operations.
September, 1999	ICICI is the first Indian company to be listed on the New York Stock Exchange (NYSE).
October1, 1999	For the first time in BSE's history, the Sensex closes above the 5,000 mark at 5,031.78.
January, 2000	BSE creates a 'Z' category of scrips in addition to A, B1, and B2 comprising scrips that breached or failed to comply with the listing agreement.
February, 2000	Internet trading commences on NSE. On February 14, 2000, BSE Sensex hits all-time high of 6,150. on February 21, NSE records peck market capitalization of Rs 11,94,282 Crores.
April 10, 2000	The Sensex is revamped to include Dr. Reddy's Lab, Reliance Petroleum, Satyam Computers and Zee Tele films replacing Indian Hotels, Tata Chemicals, Tata Power, and IDBI.
June, 2000	BSE and NSE introduce derivatives trading in the form of index futures.
July 9, 2000	BSE turns 125.
October 19, 2000	Wipro lists on the NYSE.
January 22, 2001	Borrowing and Lending Securities Scheme (BLESS) launched on BSE to promote securities lending and borrowing activities.
March, 2001	Ketan Parekh scam breaks. SEBI suspends all the broker directors of the BSE in relation to the KP scam.
May, 2001	BSE advises compulsory Demat for B2 scrips.
June, 2001	Index options start trading on NSE.
July, 2001	A SEBI directive bans carry forward. All major securities are moved to rolling settlement. Options of individual scrips start trading on NSE.
November 9, 2001	BSE and NSE launch futures in individual stocks.
January 2002 to 2005	SEBI his concentrated on Investors protection and education vigorously, Source: Business Today, January 20, 2005, p. 62-63.

Reforms in the Capital Market

The 1991- 92 securities scam prompted the government to increase the pace of reforms in the capital market. Several reform measures have been undertaken since then in both the primary and secondary segments of the equity market[17].

Primary market

(i) The Securities and Exchange Board of India was set up in early 1988 as a non-statutory body under an administrative arrangement. It was given statutory power in January 1992 through the enactment of the SEBI Act, 1992 for regulating the securities market. The two objectives mandated in the SEBI Act are investor protection and orderly development[18] of the capital market.

(ii) The Capital Issues (Control) Act, 1947 was repealed in May 1992, allowing issuers of securities to raise capital from the market without requiring the consent of any authority either for floating an issue or pricing it. Restrictions on right and bonus issues were also removed. The interest rate on debentures was freed. However, the new issue of capital has now been brought under SEBI's purview and issuers are required to meet the SEBI guidelines for disclosure and investor protection, which are being strengthened from time to time to protect investor interest.

(iii) The infrastructure of the primary market has been fairly diversified over the years with the setting up of a large number of merchant bankers, investment and consulting agencies, registrars to the issue, and so on.

(iv) The primary market has widened and deepened with public sector banks, financial institutions, and public sector enterprises in the infrastructure and power sectors increasingly rising resources from the market both by way of debt and equity.

(v) Although the process of institutionalization of the market on the supply side started in 1987-88 when many mutual funds sponsored by banks and financial institutions were set up, it gained considerable momentum in the early 1990s when many mutual funds were set up in the private sector. There are now 37 mutual funds operating in the country with a total asset base of over Rs.1 lakh crore.

(vi) The requirement to issue shares at a par value of Rs.10 and Rs.100 was withdrawn. This gave companies the freedom to determine a fixed value per share. This facility is available to companies which have dematerialized[19] their shares. Moreover, the shares cannot be issued in the decimal of rupee. The companies which have already issued shares at Rs.10 or Rs.100 per value are also eligible for splitting and consolidating the share values.

(vii) Improved disclosure standards, prudential norms, and simplified issue procedures have been prescribed. Companies are required to disclose all material facts, specific risk factors associated with their projects while launching public issue and give justification for pricing on their prospectus. The offer document is not vetted by SEBI but a code of advertisement for public issue, for ensuring fair and truthful disclosures has been introduced.

(viii) To reduce the cost of issue, underwriting by issuer was made optional, subject to the condition that if an issue was not underwritten and in case it failed to secure 90 per cent of the amount offered to the public, the entire amount so collected would be refunded[20].

(ix) One of the significant steps towards integrating the Indian capital market with the international capital market was the permission given to foreign institutional investors such as mutual funds, pension funds, and country funds, to operate in the Indian market. Foreign institutional investors were initially allowed to invest only in equity shares; later, they were allowed to invest in the debt market, including dated government securities and treasury bills. The ceiling for investment by foreign institutional investors was increased from 40 per cent to 49 per cent in 200-01. this increase can be made with the approval of shareholders through a special resolution in the general body meeting.

(x) Indian companies have also been allowed to raise capital from the international capital markets through issues of Global Depository Receipts, American Depository Receipts, Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Companies were permitted to invest all ADR/GDR proceeds abroad. Two – way fungibles was announced for ADRs/GDRs in 2000-01 for persons residing outside to sectoral caps wherever applicable.

(xi) (a) Various bottlenecks on the floatation of new capital issues, particularly for infrastructure projects, were removed. Requirements such as making a minimum public offer of 25 per cent of the issue, five shareholders per Rs 1 lakh of offer, and minimum subscription of 90 per cent are no longer mandatory for infrastructure companies.

(b) With a view to helping infrastructure companies to raise funds for their projects, their debt instruments are allowed to listed on the stock exchanges without prior listing of equity. Corporate with infrastructure projects and municipal corporations are exempted from the requirements of rule (2)(b) of the Securities (Contracts)(Regulation) Act, 1956[21] to facilitate the public offer and listing of its pure debt instruments as well as debt instruments fully or partly convertible into equity without requirement of prior listing of equity but are subject to conditions such as investment grade rating. The freedom to issue debt security granted to infrastructure companies and municipal corporations has been extended to all companies. This is subject to certain conditions. Issues below Rs.100 crore shall carry an investment grade credit rating, issues above Rs100 crore shall carry an investment grade credit rating from two credit rating agencies; the issues shall comply with the provisions of rule 19 (2)(b) of the Securities Contracts (Regulation) Act[22], 1956 regarding the size of the public offer and the promoters shall bring in the equity contribution of 20 per cent and lock in the same for three years.

(c) In respect of unlisted companies, the existing requirement of a track record of dividend payment in at least three of the preceding five years for asking an initial public offer (IPO) has been relaxed. Under the new norms, the companies will have to demonstrate an ability to pay dividend instead of showing an actual dividend paying record.

(xii) Merchant bankers are prohibited from carrying on fund-based activities other than those related exclusively to the capital market. Multiple categories of merchant bankers have been abolished and there is only one entity, the merchant banker.

(xiii) Besides merchant bankers, various other intermediaries such as mutual funds, portfolio managers, registrars to an issue, share transfer agents, underwriters, debenture trustees, bankers to an issue, custodian of securities, venture capital funds and issues have also been brought under the purview of SEBI.

(xiv) Since 1998-99, banks are permitted within the ceiling of 5 per cent of incremental deposits of the previous year prescribed for bank's investment in shares to (a) sanction bridge loans to companies against expected equity flows/issues for periods not exceeding one year and (b) extend loans to corporate against shares held by them to enable them to meet promoters' contribution to the equity of new companies in anticipation of raising resources. The approval of the bank's board is necessary. The prescription of the minimum margin of 50 per cent of loans to individuals against preference shares and debentures/bonds[23] of corporate bodies is withdrawn. However, the margin of 50 per cent prescribed in respect of equity shares has been retained. Subsequently, the ceiling amount on advances against shares to individuals was increased from Rs.10 lakh to Rs.20 lakh against dematerialized securities while the minimum margin prescription was reduced from 50 per cent to 25 per cent for dematerialized shares.

(xv) A code of conduct on advertisement has been issued for mutual funds, banning them from making any assurance or claims that might mislead the public.

(xvi) The entry norms for IPOs have tightened by modifying the Disclosure and Investment Protection (DIP) guidelines. According to the new guidelines, IPOs five times the size of the pre-issue net worth are allowed only if the company has a record of profitability and a net worth of Rs.1 crore in three of the past 15 years. Companies without such a track record or a issue size beyond five times the pre-issue net worth are allowed to make IPOs only through the book building route, with 60 per cent of the issue to be allotted to qualified institutional borrowers (QIBs). For shares issued on a preferential basis to any person by listing companies, a lock-in period of one year has been stipulated. Infrastructure companies[24] are exempt from the requirement of eligibility norms if the project has been appraised by a public financial institution and not less than 5 per cent of the project cost is being financed by any of the institutions jointly or severally, by way of loans and/or subscription to equity.

(xvii) The SEBI DIP (Disclosure and Investor Protection) Guidelines, 2000 have been amended. Permission has been granted to Foreign Venture Capital Investors (FVCIs) registered with SEBI and State Industrial Development Corporations (SIDCs) to participate in public issues through the book-building route as Qualified Institutional Buyers (QIBs). There is no lock-in requirements for the pre-issue capital of an unlisted company held by Venture Capital Funds (VCFs) and FVCIs. Exemption from the public offer requirement in view of a reduction in quantum from 25 per cent to 10 per cent and restriction of a minimum public issue size of Rs.25 crore in respect of an IPO through the book-building issue have been removed.

(xviii) Companies in the IT, telecom, media, and entertainment sectors are allowed to tap the market with a minimum offering of 10 per cent of their equity. All public issues through this route have to satisfy the criterion of a minimum Rs.100 crores issue size, follow book-building route with an allocation of 60 per cent to Qualified Institution Buyers[25], and maintain a minimum floating post-listing stock on a continuous basis.

(xix) The issuer can make a public or rights offer of shares in Demat form only. Investors have the option of subscribing to securities in either the physical or the dematerialized form.

(xx) Every public listed company making an Initial Public Offering of any security for Rs.10 crores or more is required to make an offer only in a dematerialized form.

Secondary Market

1. The open outcry trading system, prevalent till 1995, was replaced by the on line screen based electronic trading. In all, 23 stock exchanges have approximately 8,000 trading terminals spread all over the country.

2. Three new stock exchanges at the national level were set up in the 1990s. These are Over the Counter Exchange of India (1992), National Stock Exchange of India[27] (1994), and Inter-connected Stock Exchange of India (1999).

3. Trading and settlement cycles were uniformly trimmed from 14 days to 7 days in all stock exchanges in August 1996. Rolling settlement (T+5) was introduced in January 1998 for the dematerialized segment of all companies. With effect from December 31, 2001, all scrips have come under rolling settlement. The settlement cycle for all securities was shortened from T+5 to T+3, with effect from April 1, 2002.

4. With a view to maintaining integrity and ensuring safety of the market, various risk containment measures have been initiated or strengthened, such as the mark to market margin system, intra-day trading limit, exposure limit, and setting up of trade/settlement guarantee fund. Stock exchanges are allowed, subject to conditions, to use the Settlement Guarantee Funds (SGFs) for meting shortfalls caused by non-fulfillment/partial fulfillment of the obligations by members, before declaring them defaulters. The NSE set up a separate clearing corporation-The National Securities Clearing Corporation to act as counterparty to all trades executed in the capital market segment of the exchange[28].

5. To enhance the level of investor protection, the process of dematerialization of securities through the depository system and their transfer through electronic book entry is pursued vigorously. To enable this, the National Securities Depository Limited was set up in November 1996 and the Central Depository Service Limited in February 1999. All actively traded securities are held, traded, and settled in demat form.

6. Badla-carry forward trading mechanism was reinstated in January 1996, with safeguards in line with the recommendations of Patel Committee (1995) and Varma Committee (1996). The cash segment was strengthened with measures such as mandatory delivery under negotiated deals, securities lending, and continuous net settlement. All deferral products including badla have been discontinued from July 2001 following the scam of March 2001.

7. Issuing companies are required to make continuing disclosures under the listing agreement. All listed companies are required to furnish to stock exchanges and also publish unaudited financial results on a quarterly basis. Disclosure of material information, which may have a bearing on the performance/ operations of a company, is also required to be made available to the public.

8. One of the most significant reforms in the secondary market is the measure to improve corporate governance. Corporate governance[29] is a set of systems and processes designed to protect the interests of stakeholders. It is commitment to values, ethical business conduct, and a high degree of transparency. It is about creating and enchanting shareholder wealth while protecting the interests of all other stakeholders. SEBI had appointed a committee under the chairmanship of Kumar Mangalam Birla on corporate governance in India[30]. The committee framed the codes for corporate governance and suggested the implementation of the code through stock exchanges.

9. Stock exchanges have also undergone some major structural reforms. The boards of various stock exchanges have been made broad-based so that they represent different interests and not just the interests of their members. Stock exchanges, brokers, and sub-brokers have been brought under the regulatory purview of SEBI.

10. Companies are allowed to buy back their own shares for capital restructuring, subject to the condition that the buy back does not exceed 25 per cent of the paid-

up capital and free reserves of the concerned company. This buy back has been allowed to improve liquidity and enhance wealth of the shareholder.

11. The insider trading regulations have been formulated prohibiting insider trading and making it a criminal offence, punishable in accordance with the provisions under the SEBI Act, 1992.

12. Regulations are also in place for take over and substantial acquisition of shares to make the take over process more transparent and mindful of the interests of small shareholders.

13. An index-based market wide 'circuit breaker' system has also been introduced to check a sudden rise in security price, in speculation and over-trading. This system becomes active at three stages of the index movements either way, at 10, 15 and 20 per cent. As an additional measure of safety, individual scrips wise bands of 20 per cent either way may have been imposed for all securities except those available for stock options.

14. In February 1999, trading terminals were allowed to be set up abroad for facilitating market participation by non-residents. Internet trading was permitted in February 2000.

15. For ensuring greater market transparency, in 1999 SEBI banned negotiated and cross deals where both the seller and buyer operate through the same broker). Moreover all private off market deals in both shares as well as listed corporate debts were banned. So these deals are routed only through trading screens.

16. Since June 2000, trading of futures has begun. NSE and BSE have created proper facilities for derivatives trading, including conducting of regular training programmes for the same. The Securities Contracts (Regulation) Act[31], 1956 has been attended for introduction of options trading. Trading of index based and stock based options started in June and July 2001 respectively while trading of stock based future began in November 2001.

17. It is mandatory for listed companies to announce quarterly results. This enables investors to keep a close track of the scrips in their portfolios. The declaration of quarterly results in line with the practice prevailing in the stock markets in developed countries.

18. To check price manipulation, mandatory client code and minimum floating stock for continuous listing were stipulated in November 2001.

19. The government amended the Securities Contracts 9Regulation) Rules, 1957 to standardize listing requirements at stock exchanges.

20. A 99 per cent value at risk (VAR) based margin system for all scrips in rolling settlement was introduced from July 2, 2001.

21. The central government has notified the establishment of the Investor Education and Protection Fund (IEPF) with effect form October 1, 2001 the IEPF will be utilized for the promotion of awareness[32] amongst investors and protection of their interests.

22. The restriction on short sales announced in March 7, 2001, was withdrawn with effect form July 2, 2001, as all deferral products stand banned after that date.

Capital Market Developments

The capital market has passed through a phase of substantial adjustment and advancements in recent years. A significant development was the entry of public sector enterprises in the power and telecommunication sectors in the capital market to raise larger resources by issue of tax free bonds. Although this did not have any crowding out effect on the private sector borrowers, they faced stiffer competition in the market and had to come out with more attractive features attached to their issues.

The drop in the stock prices experienced during the year also the marked a corrective phase, following the boom in 1985 – 86[33]. However, it is seen as a temporary phase which would in no way deters the long-term development of the market. High rate of savings, increasing presence of households for investment in financial assets, increasing diversity of financial instruments and growing securitization of the financial market have been the basic factors providing enduring strength to the capital market. Besides, the need to raise the rate of industrial growth would require larger financial resources to be raised from the market. The market capitalization of equity shares quoted on stock exchanges is currently estimated to be around 9 per cent of GNP. This is a relatively low figure by international comparison. The share of market capitalization in GNP is 160 per cent in Japan, 65 per cent in USA, 122 per cent in U.K., 42 per cent in Taiwan, 95 per cent in Malaysia and 23 per cent in South Korea. The average price – earning (PE) ratio in India is currently in the range of 9 to 10 compared to 91 in Japan, 67 in South Korea, 32 in Malaysia and 15 in USA and Hong Kong[34]. The lower size of market capitalization and PE ratio in India are indicates of the potential for further development of the capital market in India.

Institutional Investments in Indian Capital Market

Indian capital market had been kept insulated form global capital markets and cross-border movement of capital all these years[35], as a matter of policy. Recent changes have made the economy more open to the international markets. Access to India's markets has been made easier for foreign capital, technology and goods. It is natural that the Indian Capital market should have been thrown open to the overseas investors.

In the past, overseas investments[36] had been mainly in the shape of direct foreign investment in specific approved industrial ventures. The capital market was open to non-resident Indians and, more recently, to overseas corporate bodies of Indian nationals in a restricted way. In conformity with various policy measures taken during the past year and a half, which covers Indian's external trade, collaboration and technology policies, financial restructuring etc., the Government has since announced a new policy, welcoming Foreign Institutional Investors (FIIs) to invest in the Indian capital market, both primary and secondary.

The salient features of the recently announced policy are[37]

1. Foreign institutional investors (FIIs) including pension funds, mutual funds, investment trusts, asset management companies, nominee companies and incorporated / institutional portfolio managers or their attorneys (providing discretionary and non-discretionary portfolio management services) would be welcome to make investments under the new guidelines.

2. Investment in all securities traded on the primary and secondary markets, including the equity and other securities / Instruments of companies which are listed / to be listed on the stock exchanges in India including the OTC Exchange of India is permitted. The instruments would include shares, debentures, warrants and schemes floated by domestic mutual funds Government may even add further categories of securities from time to time.

3. FIIs would be required to obtain an initial registration with Securities & Exchange Board of India 9SEBI) to enter the market, Nominee companies, affiliated and subsidiary companies of an FII will be treated as separate FIIs for registration and may seek separate registration with SEBI.

4. Since there are foreign exchange controls in force, FIIs shall also seek various permissions under FERA from the Reserve Bank of India. Both will be under a single window approach.

5. FIIs seeking initial registration with SEBI shall be required to hold a registration from the Securities Commission, or such other regulatory organizations for the stock market in their country of domicile/ incorporation.

6. SEBI's initial registration would be valid for five years. RBI's general permission under FERA to the FII will also hold good for five years. Both will be renewable for similar five-year periods later on.

7. Under the FERA permission, FIIs will be able to buy[38], sell and realize capital gains on investments made through the initial corpus remitted to India, subscribe / renounce right offerings of shares, invest on all recognized stock exchanges

through a designed bank branch and appoint a domestic custodian for custody of the investments.

8. The general permission from the RBI will enable the FII to :

   a. Open foreign currency account(s) in a designated bank. (There can be more than one account in the same bank branch, in different currencies, if so required by the FII for its operational purposes).

   b. Open a special non-resident rupee account to which all receipts from the capital inflows, sale proceeds of shares, dividends and interest could be credited.

   c. Transfer sums from the foreign currency account to the rupee account and vice versa, at the market rates of exchange.

   d. Make investments in securities in India out of the balances in the rupee account.

   e. Transfer repatriable (after tax) proceeds from the rupee account to the foreign currency accounts.

   f. Repatriate the capital, capital gains, dividends, incomes received by way of interest, etc., and any compensation received towards sale/renouncement of rights offerings of shares subject to the designated branch of a bank / the custodian being authorized to deduct withholding tax on capital[40] gains and arranging to pay such tax and remitting the net proceeds at market rates of exchange.

g. Register FII's holdings without any further clearance under FERA.

9. There would be no restriction on the volume of investment – minimum or maximum – for the purpose of entry FIIs, in the primary / secondary market and also on the lock- in period prescribed for the purpose of such investments made by FIIs. However, portfolio investments in primary or secondary markets will be subject to a ceiling of 24per cent of issued share capital for the total holdings of all registered FIIs in any one company. Conversions, out of the fully and partly convertible debentures issued by the company will also be taken into account for the purpose. The holding of a single FII in any company would be subject to a ceiling of five per cent of total issued share capital, for which purpose, holdings of an FII groups will be counted as holdings of a single FII.

10. The maximum holding of 24per cent for all non-resident portfolio investments, including those of the registered FIIs, will also include NRI corporate and non-corporate investments, but will not include; direct foreign investments (which are permitted up to 51per cent in all priority areas (and investments by FIIs through the following alternatives; Offshore single / regional funds, global depository receipts and Euro-convertibles[41].

11. Disinvestment will be allowed only through stock exchanges in India including the OTCEI. In exceptional cases, SEBI may permit sales other than through stock exchanges, provided the sale price is not significantly different from the stock market quotations, where available.

12. All secondary market operations would be only through the recognized intermediaries on the Indian stock exchange, including OTCEI. FIIs would not be expected to take delivery of purchased and give delivery of sold securities.

13. FIIs can appoint as custodian an agency approved by SEBI to act as a custodian of securities and for confirmation of transactions in securities, settlement of purchase and sale and for information reporting. Such a custodian shall establish separate accounts for detailing on a daily basis the investment capital utilization and securities[42] held by each FII for which it is acting as custodian. The custodian will report to the RBI and SEBI semi-annually, as part of their disclosure and reporting guidelines.

14. RBI may at any time request by an order, a registered FII to submit information regarding the records of utilization of the inward remittances of investment capital and the statement of its securities transactions. RBI an /or SEBI any also at any time conduct a direct inspection of the records and accounting books of a registered FII.

15. FIIs investing under this scheme will benefit from a concessional tax regime of a flat tax rate of 20 per cent on dividend and interest income and a tax rate of 10 per cent on long term (one year or more) capital gains.

16. The capital market in the present decade has magnificently responded to meet the ever-growing capital needs of both the private and public sectors. Despite the ten – fold increase in the total capital[43] raised from the market in the short span of seven years by the private sector alone, the total mobilization was only 5per cent

of the net household savings. There is no reason why the share of the net household savings has not been increasing. The other factor which must be kept in view is that, yield and earnings on equities in India are far higher than in most other countries where stock exchanges are fairly developed. Given the improvement in the general economic environment and better corporate results which are likely to follow in the wake of the massive investments in plant and technology that has taken place in the last five years, interest in corporate securities is likely to widen.

The capital market has also undergone a sea change with its scale and scope of its activities has also diversified in a multi-directional way. With the establishment of new institutions, the edifice of the capital market is strengthened and broad – based. With the significant increase in savings, many investment avenues have opened up in recent years. The review shows that the capital market in India has grown on its own impetus. The changes brought about in it since independence has strengthened it. The potential of the Indian capital market is immense which can help a great deal in establishing a welfare state in India by tapping public savings, engendering a sense of public participation as also management accountability to the public[44].

Financial innovation has brought undoubted benefits to the customers of financial services. The markets have shown that they can adapt quickly and flexibly to changing circumstances; they will probably continue to do so[45]. Achieving the objective of bringing immediate benefits to individual firms requires continued alertness to ensure that risks are adequately assessed and controlled and are priced appropriately. The technology which has nurtured these innovations is also available to help in controlling them, for efficient markets require not only the absence of distorting restrictions but also good information on which to base decisions and allocate resources. Experience has proved that no amount of fiscal and financial incentives alone, or even easy availability of finance, can bring success in industrialization efforts, unless other inputs like resourceful entrepreneurship, latest and efficient technology/know–how, professionalized management, well – motivated and skilled manpower coupled with project outselling facilities and extension services are available at every stage during the life – cycle of a project. In its promotional and developmental role, it has been, and continues to be, the endeavor of development banks to provide these non-financial inputs to the best possible extent, consistent with their resources and capability[46]. This apart, the development banks will continue to play a significant role in widening the savings market and capital market, and at the same time providing equal opportunities to employ the savings protectively thereby increasing employment, raising the level of income, reducing poverty and improving the standard of living of the people.

In South Asia, India is the only capital market capable of growing into an international center with its inherent strength which very few markets possess[47]. Both Singapore and Hong Kong are highly developed but they do not possess inherent strength. With the center of financial gravity shifting to the Middle East, India is sure to command increasing interest. But this can happen only if we are able to re-design our complex structure of regulations affecting the flow of capital. This would call for a new vision and a new strategy. We would have to emerge out of the maze we have built for ourselves. A new order is emerging. We have opened up our closed economy on a selective basis. We have to cast our sight to a new horizon. Let us hope that we will be able to see the new vision and endeavor to achieve it in the coming years[48].

The Indian Capital Market Today

The Indian capital market with over 7,500 listed companies and 23 stock exchanges is second in size only to that of the USA, in terms of availability of industrial securities. The Indian capital market offers good potential for further expansion in terms of absorption of large capital flows. It is noteworthy that despite problems faced on account of irregularities in security transactions earlier this year, the Indian stock markets have shown creditable business resilience and recovery. As per the review published by Fortune International in its, autumn Special 1992 number, the Indian capital market has appreciated by 44 per cent in US dollar terms an appreciation rate which was second only to that of the Philippines at 71per cent. Comparable statistics for other emerging markets are : South Korea (-) 24 per cent, Indonesia (-) 5 percent, Singapore 5 per cent, Malaysia 9 per cent, Hong Kong 39 per cent, etc. it is true that the price – earning ratio of 29 is comparatively high when compared with the prevailing ratios in the afore – mentioned markets. But it needs mention that in the Indian market; the PE ratio is influenced to a very large extent by 4 or 5 leading scrips. If one leaves out these scrips, the PE ratio would certainly compare favorably with those prevailing in other emerging markets. In fact, considering that active trading is confined to few hundred scrips, it is conceivable that with substantial inflow of foreign capital, many of the currently dormant scarps, mainly of medium – sized corporate bodies, would show growth potential.

There are a couple of areas where some improvement will be necessary. The first is the factor of a long time between the transaction and the actual registration of transfer of securities a present. Secondly, the reporting and controlling system will have to be geared up to ensure compliance with the stipulations regarding upper limit for investment in a domestic company (24per cent) and by a particular investor (5per cent). The Reserve Bank authorities confirm that steps are being taken to overcome these problems.

Following the recommendations of Chakravarty Committee Report on Monetary System, the RBI[49] during the year, began the auction of 182 days treasury bills in the money market. The objective of this measure has been to broad base the development of money market by introducing new instruments, create an active secondary market, bring the interest rates on treasury bills to the market level and gradually reduce the monetization of public debt.

Strengthening the Capital Market in India

The Abid Hussian committee[50] on development of capital market has suggested creation of two-tier stock exchanges along with a number of fiscal measures to streamline the stock market for bringing stability and restoring investors' confidence. It has recommended long-term policy measures to bolster the capital market so that industries with a proven track – record could meet their financial need form the growing capital market. The public sector financial institutions could then be made to cater to the needs of the newly emerging companies for survival and sustenance during their nascent phase.

During the stock exchange boom of 1985 – 86[51], a number of listed companies disappeared overnight giving rise to the fly by night phenomenon. The committee noted that most of these companies were largely promoted by merchant banks, which were found to have received commission in the process.

The committee recommended that all the companies should go through the registered merchant banks when they went public. The merchant banks should scrutinize the new companies entering the capital market, besides certifying that they were viable. This would act as a safeguard on the listing of new companies.

Yet another major recommendation dealt with the development of market makers, not prevalent in the exchanges now. The report proposed that merchant banks enter into a tie up with the brokers to quote a cost-effective floor price[52].

To finance the buying or selling of shares, it called for provision of institutional financing through commercial banks. The committee recommended simplification of procedures involved in transferring of shares, which are considered to be complicated and cumbersome at present. This included recommended simplification of procedures involved in transferring of shares, which are considered to be complicated and cumbersome at present. This included the creation of a network of corporations akin to the proposed Stock Holding Corporation of India (SHCL) under the leadership of the IDBI so that private investors could freely transfer the shares[53]. The report urged that a highly reputed national level institution be set up to undertake multiple memberships in stock exchanges throughout the country. The committee also underlined the need to open new instruments such as non-voting shares with higher dividends than the voting shares. This would remove the fear of capture of managements of the companies as harboured by some efficiently run units.

Capital Market in the Process

The important task of the economy has always been to strengthen the capital market largely though stimulation of private investment. This could be achieved by effecting structural changes to the capital market, widening the scope of fiscal incentives and to impart some mobility to it. It is also equally important to protect the value of savings held in the form of fixed interest securities, which is the mainstay of fixed income earners. This will help in strengthening the capital market and improve the economy.

The Indian capital market has developed to a large extent but is still in a process of evolution. Various measures have been taken, especially in the last two years, to develop a healthy and mature capital market. These include implementation of Dave Committee[54] recommendations for phased liberalization of stock market operations, opening up of the stock exchange membership to financial institutions and corporate bodies, encouraging banks and financial institutions to go in for mutual funds, finalization or rating symbols by CRISIL to guide investors, the setting up of the DFHI to create an active secondary market and most important of all, the establishment of SEBI to regulate stock exchanges so as to promote a healthy and orderly securities market, however, one more are which requires serious attention is the scope for a multi-tier market.

Over time, while the Securities market has expanded manifold, the structure and working of the market has remained unchanged. At present through, various securities traded in the stock exchanges are different in nature they are all subject to the same listing requirements. The size, liquidity, floating stock, volume of trade, company's performance, etc., of listed companies differ widely, still they all are treated as par. The existing uniform listing requirements are neither suitable to the investor, who is not aware of the differences in securities, nor to the issuing companies whose needs are diverse[55].

The SEBI[56], in its approach paper, has referred to its plans to seek and promote a mortifier market structure, with different tiers having distinct characteristics suited to the differing needs of issuers and investors. Each tier would have its own listing requirements. The primary objective of such a structure would be to ensure that the market is attractive to issuers of different sizes and is suited to their needs to impart liquidity to issues and to provide appropriate incentives to elicit good response form the investors.

There is no doubt that there is need for a multi-tier market. However, as a first step, it should be advisable to have a two – tier market. It has been suggested that public issues below Rs. 3 crore should form one tier of the market, while those above Rs.3 crores can form the other elevated tier of the market. Such bifurcation would help the smaller companies to mobilize resources at a lower cost, with less stringent requirements, and provide a way for companies to gradually move up to the elevated market as they grow. The higher tier would be subject to stringent requirements of disclosure to stock exchanges and investors[57]. These shares would obviously be more liquid. The investors on their part would be aware of the relative liquidity and risk and the reward profile of alternative investments.

The idea behind the introduction of a two-tier market is to insulate the general public from the relatively high risk shares in the lower market. This should be possible since only those persons having the capacity to take risks and the necessary expertise to make professional judgment would operate in this market. Mainly financial institutions, banks and their subsidiaries and brokers would actively participate in this market. The companies with relatively few shareholders, with in recent trading history or those having only local or regional investor interest, would be attracted to this lower tier of the market. The envisaged two tier of the market would continue to form part of the existing securities exchange market.

Another type of secondary securities market being envisaged is the Over the Counter (OTC) Market[58]. The difference between the two is that a securities exchange market operates on auction basis, whereas an OTC market functions on the negotiation principle. In an exchange market, many buyers and sellers compete for the best share price through agents, whereas in the OTC market, intermediaries (brokers/dealers) for one buyer and one seller seek each other and agree on a trade price. In the OTC market, there is no physical meeting place for buyers and sellers. Instead they find each other through electronic network or by telephone or telex. There is no double auction method as practiced by the exchanges. Instead the market in a stock is maintained by firms that act as dealers by establishing positions in a security.

An important and unique characteristic of an Indian capital market, that has been lost as a result of globalization of the market, is the isolated nature of the markets[59]. The Indian markets till now were neither linked to global markets nor were affected by ups and downs being experienced by global markets. As a result, the markets continued to remain buoyant even during Gulf War and other world crisis[60]. However, now the markets are reportedly more volatile and no more prone to economically beneficial happenings overseas. This would necessitate a need for greater intervention and stricter policing and hence there is a need to give greater freedom and more powers to SEBI, the supervising authority in the Indian market.

The volume of capital market activity has increased substantially over the last couple of decades though in the most recent period, for various reasons, activity has been somewhat subdued both in the primary and secondary markets. The period has also witnessed some widening and deepening of the market and the emergence of new institutions, such as merchant banks and mutual funds as well as new investments. Venture capital companies have also made their appearance but they have not grown anywhere near their potential, as exemplified in the U.S. or the need for them given the contribution they can make to convert innovative scientific ideas into commercial propositions and for their role in promoting techno entrepreneurship. This calls for proactive policies such as fiscal concessions and a supportive set of operational guidelines including encouraging foreign venture companies to set up in India[61].

The expansion of capital markets to meet successfully the changes of future requires the correction of some long standing systemic deficiencies stemming from institutional and procedural aspects of the functioning especially of secondary market institutions. This is being done and there is now a greater measure of transparency at a result of the requirement of fuller disclosure and the arrival on the scene of investment oriented research agencies. Reform of the stick exchanges is also under way[62]. A depository system has been introduced and dematerialized trading is picked up.

Computerized on-line trading between markets is gathering momentum and the presence of the National Stock Exchange has made enormous difference acting as it does as a space setter for improved market procedures.

The reform in the Indian capital market[63] would gain added significance in the context of a measure of internationalization of Indian Capital markets. For the Indian system to derive the full benefits and avert risks involved in the process, a structured and sequenced integration would be needed. The greater interaction of Indian and international markets would necessarily involve further improving our procedures and practices. Foreign investors are used to open trading systems within the framework of prudential regulation. Their markets are also characterized by adequate disclosure and research cased information and severe penalties for insider trading. Our markets would need, both for their own development and to promote fruitful linkages with foreign capital market, to conform to these principles.

Factors behind erosion of investors' confidence

There has, of course, been much discussion in India on the erosion of the ordinary investor's confidence in the market. A succession of finance ministers of the Central Government have attempted to solve this problem since 1996 but none succeeded. The basic problem is quite straightforward and we should be clear about it. It is simply the problem of assuring the investors of fair dealing orderly and efficient market and protection against frauds. If the regulatory authorities are unable to ensure even this, hey are not worth their salt.

The problem mentioned above is more fundamental than periodical ups and downs, or cyclical behaviour, which is a well-known characteristic of all stock markets. Of course, the ups and downs can be accentuated by improper market regulation.

The erosion of retail investors' confidence in the market can be tackled effectively only if we can clearly identify the underlying factors. It is observed from past research studies, the following are some of the factors responsible for the gradual withdrawal of investors from the capital market.

Deficient Corporate governance

The single greatest worry as identified many researchers, is "fraudulent company management", a corporate governance problem[64]. It is a well known phenomenon that there has been a worsening of the corporate governance problem in India. This means that the SEBI-prescribed corporate governance code had absolutely no effect.

The corporate governance problem has recently become a hot subject of public debate. The recent proposals made by two new committees, viz., the Naresh Chandra Committee on Corporate Audit and Governance (appointed by the Department of Company Affairs) and the Narayana Murthy Committee on Corporate Governance (appointed by SEBI, are well-intentioned and look good on paper, but they have some serious deficiencies which are likely to mar their effectiveness in achieving the professed purpose,. In particular, these committees do not take into account the complexity of the governance problem caused by the existence of controlling blocks in most of the Indian companies.

Price Manipulation and Volatility

As against the worsening of the corporate governance problem, a positive development in the Indian stock market has been that price volatility and price manipulation have both come down significantly over the last one year or so. Both these sources of investors' worry were more important than the factor of fraudulent company management[65]. This was so because speculation and manipulation had reached scandalous heights and finally led to the market crisis of March 2001.

1. **Extremely weak regulation of the market**

   Majority of ordinary investors are of the opinion that the regulation of the Indian stock market was largely ineffective in protecting investors and ensuring fair dealing and orderly markets. This was the dominant perception of household investors in India.

2. **Retail investors' attitudes**

   It is often stated that most of the retail investors are short-term investors. Interestingly, it is found in one of the studies that a large majority, of household investors are long term oriented investors, who ordinarily buy share with the intention of holding them for "some years". This contradicts the popular belief.

Only a relatively small fraction of Indian household investors are frequent traders or speculators.

3. **Households' tendency to reduce equity exposures**

There is a common tendency among the household investors that to reduce their exposure to equity investment, i.e., to gradually withdraw from such investment. This kind of tendency has been prevailing[66] among Indian households since 1997.

4. **New issue market vs. Secondary Market**

Between the secondary market and the new issues market, household investors have in recent years shown distinctly greater preference for making secondary market purchases of shares rather than for buying new issues. This represents a reversal of the traditional household preference for new issues. It is the result of greater safety and transparency of secondary market operations on one hand, and the general quality deterioration and over-pricing of new issues, on the other.

5. **Share owning population shrinking**

The share owning population in India has started to shrink since around 1996-97, instead of growing. It is partly due to discouragement of small and long-term investors due to burdensome and inequitable share depository changes in India. The market's role in mobilizing household saving has declined sharply since 1994-95. The result is that all capital market instruments are presently at the bottom of investment preference scale of household's investors in India. The RBI data shows that out of household saving in the form of financial assets during 2001-02, only pitiful 2.4 percent was in the form of shares, debentures, UTI[67] and other mutual fund units and that this percentage has shown a decline since 1994-95. It is important to note that the household investors are more inclined in recent years to reduce their exposure to equity, i.e., they are tending to withdraw from the equity market.

6. **Direct shareholding Vs mutual fund schemes**

In India so far, Mutual funds have failed to gain recognition among households as a sager and superior route to channel savings into the capital market than direct holdings. This is indicated by the fact that the Indian households overwhelmingly continue to prefer direct shareholding instead of mutual funds. The percentage allocation of savings by households to direct purchase of shares far exceeds the allocation to mutual fund schemes of all types taken together. Within mutual fund schemes, income schemes clearly command the top-most preference among Indian households. Index funds have not found much favour among household investors in India

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