CHAPTER 1
INTRODUCTION

Stock markets the world over have been in a constant state of evolution reflecting the changes that market participants craved for. By about 1991, both the world and the national economic scenes had undergone a radical change. The failure of the centralized, planned economic system in the Soviet Union, coupled with the apparent success of market-oriented economic policies not only in the West but also in South-East Asia served to enhance the attraction for market friendly economic policies all over the world\(^1\). The revolutionary advances made in information and communication technology and the trade policies pursued by the U.S. made it impossible for any country to be an island and remain outside the global economic system.

The reform process was initiated by the Government of India in 1991-92. This constituted an almost total reversal of the policies followed till then. The opening up of the economy to foreign capital and integration with the global trading system called for the dismantling of the license permit Raj.\(^2\) The conditions accompanying the IMF loan also required phasing out of subsidies to the agriculture and the public sectors

---


\(^2\) Ibid.
and encouragement of the private sector. A number of sectors hitherto
controlled by the public sector have been opened up for investment by
the private sector. The Government has realized that the private sector
has a decisive role to play in the country’s development efforts.

To promote foreign portfolio investment, Foreign Institutional Investors have been permitted to invest in all securities traded on the primary and secondary markets. Foreign broking firms have been allowed to deal directly in the Indian stock markets.

1.1 Emerging role of financial services

The Financial services industry may be defined as the collection of organizations, which intermediate and facilitate financial transactions of individual and institutional investors resulting from their resource allocation activities through time. Stock market, a major component of the financial services sector, plays the role of intermediation in mobilizing the savings of the people and allocating it for productive investments. It provides a market where shares and other securities of enterprises can be bought and sold. It thus facilitates free movement of capital and acts as a channel of employing savings of

---

the people effectively. It also assists the Government in selling and buying its own securities.

The liberalization measures of recent years have given rise to substantial growth in capital market in our country. In the financial year 1998-99 an amount of Rs.5586 crores was raised from the primary capital market. The number of listed companies has increased to around 10,000 with market capitalization of Rs.6,00,000 cores. At present a number of companies have listed their securities in international stock exchanges. Various financial instruments have been designed to suit the requirements of suppliers of funds ranging from commercial paper to GDRs (Global Depository Receipts) and derivatives.

1.2 Economic Background of Kerala

Kerala, Gods own country, as the popular tourist promotion slogans proclaim, is a land of green magic. Spread over an area of a mere 38,864 sq.km. or just one percent of the total area of India, the state of Kerala supports almost four percent of the country's population. Measured by social indicators like basic literacy, longer

---

5 Rishi Chopra, "India has 10,000 listed companies but few trade regularly," Economic Times, Mumbai, Vol.41, No.1, May 14 2001. p.16.
life expectancy, low infant mortality, easy accessible health services and high social standing of women in general, the state is well ahead of the other states in the country.

Kerala is blessed with an abundance of natural endowments, which have helped the state to produce in relation to the country's total production 97 percent of pepper, 93 percent of rubber, 80 percent of tapioca, 60 percent of cardamom, 60 percent of coconuts, 20 percent of coffee and 10 percent of tea. The state has a high consumption level. This is largely explained by the flow of inward remittances from non-residents and the burgeoning growth of the service sector with high income earning potential. More and more people migrate overseas and to other states in India in search of gainful employment.

Notwithstanding these favourable circumstances, Kerala's economic record leaves a great deal to be desired. The per capita income has remained below the all-India average, the growth rate in agriculture has witnessed a declining trend, industrial investment has been low and all these have combined to aggravate the problem of unemployment. Several reasons have been put forward for the economic backwardness of Kerala. They consist of labour militancy, high wage rates, diversion of capital in unproductive areas, lack of

\[\text{ibid.}\]
basic raw materials, poor financial record of the state enterprises, high cost of land etc. While all these factors are there, it must be stated that the single most important reason is that Kerala is not competitive in terms of cost of operation. The state suffers from low ratio of utilization of the installed capacity, input shortages and administrative hassles. The effect of increased cost is demonstrated not only in the flight of capital but also in the shifting of the existing plants to other states. There is a strong need for massive effort by all concerned to create conditions for promotion of industrial productivity.

Special efforts are needed to restore the fortunes of the traditional industries like coir, cashew and plantation crops which for many years have suffered from neglect while policy initiatives have been concentrated on the development of new industries. The traditional industries are the backbone of Kerala's economy and it is therefore imperative that they should be restored to profitability.

Kerala's greatest and most fundamental need is to achieve rapid economic growth. Given a sustained growth, the rest of the state's problems will take care of themselves. The state enjoys a sustainable competitive advantage by virtue of its high literacy rate and skilled man power. There is a unique opportunity for Kerala to leverage these resources and achieve rapid economic growth.
Economic growth is the one and only way of removing the black spots of poverty and unemployment.

Though Kerala has enough and more bank deposits, people are not willing to borrow and make productive investments. As a fallout of this, the credit-deposit ratio in the state has come down significantly. From a high of 59:1 in 1991, the C-D ratio has come down to 43:1 in 2000.8 With state funding of project becoming difficult, the necessary resources can be procured only from the capital market. The Cochin Stock Exchange with 508 strong members can play the role of intermediation in channelising the resources of the community efficiently to productive lines. With high literacy level, the equity cult will spread very fast, if properly marketed. The brokers have a unique role to play in the formation of capital within the state. The surplus generated in the agricultural sector and the high level of savings of the middle class and the rich are available for investment in the capital market. It requires the ingenuity of the participants in the financial services industry like the merchant bankers and the broking fraternity to design instruments which could reach these depths and bring out these surpluses.

1.3. Statement of the problem

The problem under study is 'Problems and prospects of stock-broking in Kerala'. In order to transact business in the securities market, an investor must use the facilities of a brokerage firm unless he is himself a member of an organized exchange or is a registered dealer in securities.

Stock-broking service refers to the service provided to the investors wherein the agency takes the responsibility of buying or selling of securities.\(^9\)

The brokers do not function as principals in these transactions; they are agents only. Brokers charge a commission on each purchase and each sale, which they execute, but they ordinarily get nothing unless they can complete a transaction. They also render incidental services like consultancy, equity research, portfolio management, custodial services, depository services and underwriting.

Besides clients, they have to deal with a number of agencies like sub-brokers, merchant bankers, bankers, companies and Registrars to issues.

---

\(^9\) Ravi Shanker, "Services Marketing- The Indian Experience", South Asia Publications Delhi, 1998, p.177
The stockbrokers face multiple problems while they discharge their functions. They take very high risks in connection with their own investment, development in the corporate sector, behaviour of sub-brokers, and clients etc. The last three or four years saw the advent of the National Stock Exchange terminals in the state. With high liquidity and greater volume of trade, they could attract more investors. But these terminals have snatched away a good chunk of investors resulting in poor business for the CSE (Cochin Stock Exchange) brokers. With increasing competition and decline in number of investors, the brokerage rates have fallen from 2 percent to 0.5 percent or even less.10

Though there are over 240 listed companies at the CSE, the trading is confined to a few select blue chips.11 Many companies fail to pay the annual listing fees to the exchange. For creating the necessary infrastructure, the brokers have spent huge sums on computerization and for training the existing staff. Unfortunately, it has not produced much result. The resource base of brokers is not adequate. To finance their activities, they are forced to arrange loan at a hefty rate of interest from private money lenders. Unbridled speculation, lack of transparency in dealings and rampant insider trading are some other problems confronting the brokers. Ethical standards are ignored by

---

11 Ibid.
some brokers. As a result, the credibility of the entire broking community is eroded. The profitability of investing in industrial securities is not properly marketed in Kerala. Owing to poor investment consultancy by stockbrokers, the confidence of investors has been shaken. As investors are inactive during the bearish phase of the market, brokers fail to generate regular income from brokerage.

Absence of proper training facilities acts as a major hindrance to stockbrokers in expanding their business horizon. Pricing of the service, namely brokerage is not uniform. The brokerage charged has to be in the right proportion to the cost. Moreover, brokers lack professionalism in their attitude and approach when they deal with clients. Lack of Government patronage and protection is another cause worrying them.\textsuperscript{12}

Stock-broking service offers tremendous opportunities for the rapid development of the capital market in Kerala. Earlier stock-broking was a much subdued industry. Today it has evolved into an important commercial activity. The study deals with the various prospects and opportunities of stock-broking in Kerala.

\textsuperscript{12} Ibid.
1.4 Objectives of the study

The objectives of the study include the following:

1. To trace the history and growth of stock-broking in India and Kerala.

2. To study the various instruments, devices and techniques adopted by stockbrokers to render their service.

3. To study the practices adopted by stockbrokers to market their service.

4. To study the accounting methods and practices adopted by stockbrokers in Kerala.

5. To study the threats and challenges confronted by the stockbrokers in Kerala.

6. To evaluate the effect of SEBI regulations on stock-broking in Kerala.

7. To study the strengths and opportunities of stock-broking in Kerala.

8. To make suitable suggestions on the basis of the findings of the study.
1.5 Necessity and Relevance of the study

Stockbrokers, as a community, have to face many practical difficulties at present. The Government has introduced a number of controls and regulations through the SEBI in the capital market, which has caused confusion and suffocation to the stock-broking community. Fast emerging areas like security analysis, equity research and portfolio management are not given adequate attention by brokers. The stock-broking business has to attract qualified management graduates, professional accountants and security analysts. Brokers are not updating their skills and they find it difficult to cope with the changing environment. Investors generally complain about lack of transparency in dealings and frequent insider trading by brokers.

The success of a stock exchange mainly depends on the efficient functioning of the stock-broking community. It can be said that the very foundation of the stock market lies in the effectiveness of the performance of stockbrokers. They are the vital link between the investors and the promoters. The present study is very relevant since it aims to analyze the problems of stock-broking and to give valuable recommendations to overcome them. At present stock-broking is considered to be less dignified and the needed importance is not given to this profession. In fact it has grown into a profitable business avenue.
and is able to create gainful employment opportunities to many people. It should be given a scientific basis so that the procedures, methods and practices of stock-broking are systematized and thereby attract new generation to this profession. Hence it becomes necessary to evaluate and critically analyze the existing stock-broking services and also to search for new dimensions and avenues and better prospects for this profession.

Though many research studies have been made in the area of stock market on price movements, investor behaviour, mutual funds etc., no concrete study has been made on stock-broking in Kerala. Since the topic selected for the research is of great significance and relevance, it is considered worth studying.

1.6. Methodology and Sample Design

The study covers a period of four years starting from August 1997 to July 2001. For the purpose of study both primary and secondary data have been collected.

1.6.1. Collection of Primary Data

Since most of the brokers are residing in and around Kochi, the survey is concentrated in Ernakulam District. There are members
belonging to other districts also. But all of them travel to Ernakulam where the Stock Exchange is situated for the purpose of trading. In all, information is collected from 200 brokers approximating 40 percent of the total population, which consist of 508 members. The list of members has been obtained from the Cochin Stock Exchange and the samples are selected by using simple random method. To ensure randomness of selection, all members of the population have been numbered on separate slips of paper, mixed up and selected to constitute the size of sample. A structured questionnaire containing pre-ordained questions is used for eliciting the required information from the respondents. A pilot study has been conducted for testing the effectiveness of the questionnaire. Both open-end and closed-end questions are incorporated in the questionnaire. The data for the period starting from January 2000 to December 2000 are collected for the study. The information is collected through personal interviews and by mailed questionnaire method. Effort has been made to compare and verify the collected information with other independent sources of information.
1.6.2. Collection of Secondary Data.

Secondary data have been collected from published articles of newspapers, journals, annual reports of the CSE and other agencies, final accounts and other relevant documents. The Internet and other available means have been tapped for collecting secondary data.

The collected data have been condensed into manageable groups and tables for detailed analysis. Statistical tools of percentages, averages, co-efficient of correlation, Chi-square test, tables, graphs and bar charts have been used for analyzing the collected data. On the basis of the analysis, valid conclusions and generalizations have been drawn. Finally, recommendations and solutions have been made on the basis of the findings.

1.7 Key terms and definitions

1.7.1 Arbitration

It is a quasi-judicial process, which involves settlement of claims or disputes between member-brokers and between a member and his clients, authorized clerk, sub-brokers etc., through appointed arbitrators.13

1.7.2. Auction

It is a mechanism utilized by the exchange to fulfill its obligation to a counter party member when a member fails to deliver securities or make the payment.

1.7.3. Backwardation Charges

Also known as undha badla, is the charge paid by the short seller for borrowing securities.

1.7.4. Bear Market

A market characterized by decline in market indexes and prices of most shares.

1.7.5. Broker

A licensed member of the stock exchange who has been permitted to buy or sell shares on his own or on his client’s behalf is called a broker.

1.7.6. Bull market

A market characterized by rise in market indexes and prices of most shares.
1.7.7. BSE-Sensex

It is an index of Bombay Stock Exchange representing 30 shares.

1.7.8. Cash settlement

In a cash settlement the buyer is required to take the delivery of shares and the seller is required to give delivery of shares at the end of the settlement period.

1.7.9. Circuit breakers

It is a mechanism by which exchanges temporarily suspend the trading in a security when its prices are volatile and tend to breach the price band, which is fixed at 16 percent of the previous day's closing price at present.\textsuperscript{14}

1.7.10 Clearing

It refers to the process by which all transactions between members are settled through multilateral netting.

1.7.11 Demat shares

These are shares that are dematerialized and held in electronic form.

\textsuperscript{14} Ibid.
1.7.12 Derivatives

Derivatives are instruments whose value is derived from the value of one or more underlying assets like commodities, precious metals, currency, bonds, stock, stock indices etc.

1.7.13 E-broking

It is the broking service extended to investors by which they can trade in securities through the Internet.

1.7.14 GDRs (Global Depository Receipts)

These are instruments used in raising capital at global levels.

1.7.15 Hedging

It is a risk containment measure, which protects oneself from the normal risk of price fluctuation in assets.

1.7.16 Margin trading

It is also called non-delivery mode of trade, which means trading in shares over and above the deposited levels.
1.7.17 Mark up price

Also known as hawala rate is the price at which a security in the specified list can be carried forward.

1.7.18 Market-Making

Market-making means offering buy and sell quotes for shares to increase their liquidity.

1.7.19 Non-delivery period

Whenever a book closure or record date is announced by a company, the exchange sets a non-delivery period for that security. Though trading is permitted in the non-delivery period of that security, the trades are settled only after the non-delivery period is over.

1.7.20 Over-the-Counter trading

Trading in those stocks that are not listed on a stock exchange.\textsuperscript{15}

\textsuperscript{15} \textit{Ibid.}
1.7. 21 Pay-in

Pay-in day is the designated day on which the securities or funds are paid in by the members to the clearing house of the exchange.

1.7.22 Pay-out

Pay-out is the designated day on which securities and funds are paid out to the members by the clearing house of the exchange.\(^{16}\)

1.7.23. Price-rigging

When a person or persons in concert with each other collude to artificially increase or decrease the price of a security, that process is called price rigging.

1.7.24. Record date

It is the date fixed by the company to decide ownership benefits of an investor.

1.7.25. Dematerialization

It is the process through which the shares held in electronic form in a depository are converted into physical form.

\(^{16}\) Ibid.
1.7.26. Risk averse broker

A broker, when faced with two investments with the same expected return but two different risks, prefers the one with the lower risk.

1.7.27. Risk neutral

One who is prepared to take moderate risks.

1.7.28. Screen-based trading

It takes place when buying or selling of securities is done by using computers and matching of trades by a stock exchange computer.\(^{17}\)

1.7.29. Settlement

It refers to the scrip-wise netting of trades by a broker after the trading period is over.

1.7.30. Settlement guarantee

It is the guarantee provided by the clearing corporation for settlement of all trades even if a party defaults to deliver securities or pay cash.

\(^{17}\) Ibid.
1.7.31. Settlement Period

It is the time given to settle the trades.

1.7.32. Short-Position

The position created by a speculator resulting in selling of securities without possessing shares.

1.7.33. Trade guarantee

It is the guarantee provided by clearing corporation for all trades that are executed on the exchange.

1.7.34. Trading Cycle

It refers to the number of days on which a person is allowed to carry out trading in securities.

1.7.35. Vyaj badla

Also known as contango charges, which means the charge or interest paid for carry-forward trades.

1.8 Limitations of the study

The study is not without its limitations. The major limitations are given below:
1. The present study could not cover all the aspects of stock-broking in Kerala due to time and resource constraints. However, the major problems of stock-broking have been considered for the study.

2. The time constraints of some of the respondents may have forced them to disclose information without examining the issues seriously.

3. The data was mainly collected in the bearish phase of the stock market and the brokers were in a dejected mood. This might have acted against giving a natural response to the questions called for answer.

4. As per the Members' Directory of the CSE, 60 percent of brokers are not engaged in stock trading at present. But majority of brokers from whom data have been collected are engaged in stock trading.

1.9 Scheme of the Study

The present study has been presented in seven chapters.

The first chapter elucidates the background of the study, statement of the problem, objectives of the study, methodology, key
terms and definitions, limitations of the study and scheme of presentation.

The second chapter reviews the existing literature on the subject.

The history and growth of stock-broking in India and Kerala is outlined in the third chapter.

Stock market practices, instruments and devices made use of by brokers in trading are described in the fourth chapter.

The fifth chapter analyses in detail the problems of stock-broking in Kerala.

The sixth chapter explores in depth the other problems confronted by brokers and the prospects of stock-broking in Kerala.

The last chapter focuses on summary of findings and recommendations.