CHAPTER 2

REVIEW OF LITERATURE

Stock-broking service, a branch of financial services sector, is undergoing rapid changes. The changes that are taking place in the financial services sector are reverberated in the stock market also.

The practices and techniques adopted and found to be successful in other stock markets are being implemented in the Indian Stock Market also. Some of the practices and techniques thus implemented are screen based trading, dematerialisation of share certificates, options and futures trading, Automatic Lending and Buying Mechanism (ALBM), rolling settlement, etc. A number of learned writers have expressed their opinion about the recent trends and practices adopted in the Indian Stock Market. The difficulties and problems experienced by brokers are also highlighted by many writers. A brief review of their ideas, thoughts and comments are narrated in this chapter.

Indicating a strong sentiment against speculation in the stock market, Vijayaraghavan R (1992) suggests that the exchanges should adopt as quickly as possible a uniform settlement system so that wide price variations across exchanges can be avoided and the ordinary
investor afforded protection from violent price swings. Further, he adds that the stock exchanges should work towards a shorter settlement period, which would tone up market efficiency and ensure that payment and deliveries are made in time.¹

Rajiv Handa (1995) makes a comparison of practices in developed markets and developing markets. He says, “It is in the developed markets of the West that business trends, trade cycles and a host of other factors are taken care of by computers and forecasting models. This information is backed by decades of diligently stored data which is updated by continuous release of contemporary information by the listed companies”. He further states that the situation back home is materially different and the company reports are available six months after the year ends which lose relevance by the time they are analysed.²

Suresh Prabhu (1995) participating in a seminar organised by the Cochin Stock Exchange on ‘stock-broking in the changed scenario’, points out, “In order to become successful in the share broking business, the changed scenario looks for professional standards, functional strength backed by corporate right, ethical behaviour and a

comprehensive and total approach to business from the part of stockbrokers”. He also states that with corporatisation of memberships, the members shall provide multiple services to investors.

In his opinion, the brokerage charged has to be responsive to the cost. He concludes his presentation with the remark that there is tremendous opportunity in the state of Kerala for development of capital market activities.3

Chari P.S.U. (1995) discusses the emerging role of financial services. He states that a vibrant and competitive financial system is imperative to sustain the ongoing reform in the structural aspects of the real economy. Disclosure requirements and accounting practices too have to be in line with international standards. Areas like security analysis, equity research and portfolio management are fast emerging financial services.

According to him, one major factor which may perhaps retard the growth of this sector is the dearth of qualified and trained personnel. A proper training set-up which can provide comprehensive training to the intermediaries has become imminent.4

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Louis K.K. (1996), Senior Programmer, Cochin Stock Exchange, speaks about the implementation of screen based trading at the CSE. “Our mission is to develop Cochin Stock Exchange as a modern stock exchange which will help capital formation for industrial development of India by providing issuers, national and foreign investors with fair, secure and efficient market place. We will achieve this through novel modernisation measures, sound trading and settlement systems, modernisation of operations, transparency of business, professionally qualified and extremely dedicated team for better regulation of trading; and ensuring investors' care”. He concludes his presentation with the remark that the CSE would become a high-tech model stock exchange at par with international counterparts.5

Menon T.N. (1996), a member of the Cochin Stock Exchange speaks about market making. In his opinion, good market-making is essential not only for inactive securities, but also for moderately active and daily traded securities. Such an activity will need the support of the banking system and also co-operation from the listed companies. He further points out that because of varying market sentiments and changing investor perceptions, there will always be mis-match between buying and selling orders of investors in respect of any security on any given day in the market in terms of timing and quantity. This leads to

buying orders remaining unexecuted on the one hand and poor liquidity for those who wish to disinvest on the other hand. It is against this background that the role of efficient market-making has been widely recognised in the leading stock exchanges of the world as essential intermediaries.⁶

Cautioning the broking community, Sivakumar, K. (1996), says that stock-brokering is at the crossroads, with the falling values of stock exchange membership cards and the rapidly declining brokerage levels and jobbing spreads. He feels that the broking community, barring exceptions, is also not equipped to handle the rapid changes in the environment. With the setting up of the National Stock Exchange, there has been a major use of technology for stock market trading. At the share-brokering level, the decline of regional stock exchanges is visible. Individual stockbrokers, who are unable to cope up with a combination of increased responsibilities and requirements, fall in activity level and diversion of business to major exchanges. He concludes that the broking community shall recognise the changes and work towards consolidation and positioning in such a way as to be able to take advantage of opportunities that lie ahead.⁷

Mayya M.R. (1996), warns the stockbrokers by stating that the business in stock market is shrinking with the small investors having virtually deserted the market. The disenchantment of small investors for equity investment has adversely affected the existence and survival of the broking community. He observes that some of the policy decisions taken by the authorities are responsible for the small investors' exit out of the market, although the policy makers have certainly not desired so. He is of the view that pricing of new issues shall be subject to strict norms as the deep erosion in prices of new issues on a wide front has been the single most important factor which has caused total dismay among the small investors.8

Pointing out the difficulties of the stock-broking profession, Krishnakumar P.K. (1998) speaks about brokers in the Cochin Stock Exchange, "Faced with a shrinking primary market, and a slothful secondary market the brokers in the Cochin Stock Exchange are fighting with their backs to the wall. It is a dismal scenario. Several brokers have called it quits. Some have shifted to other jobs. A few are thinking of merging to become a corporate entity". He further adds

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that brokerage has taken a beating and with client support having dried off, the brokers are left with speculative business.º

Tomy Varghese (1999) makes a study on individual investors in the capital market in Kerala. On professional competence he states that brokers are not well informed. His survey reveals, “53 per cent of investors feel that brokers are not honest and about 83 per cent have experienced delay in payments. However, the majority of the investors (74 per cent) consider that brokers are helpful”¹⁰

Realising the plight of small stock exchanges, Rajeshwari Adappa Thakur (1999) suggests that all small-cap companies should compulsorily list on small exchanges while the large-cap companies could list on the larger exchanges. As listing fees are an important source of income for some exchanges, it has been suggested that a centralised system of collecting listing fees should be adopted wherein the larger exchanges would collect the listing fees from the companies. These in turn could be distributed among all the exchanges, irrespective of whether or not the company is listed on the other

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exchanges. He further adds that small exchanges are to use their infrastructure for other uses such as a commodities exchange.

Neeraj Kaushal (1999) feels that the stock exchanges should go public. He further adds that stock exchanges are in fact, structured along the lines of a country club owned by a group of privileged people or corporations. Ordinary investors should be allowed to take membership of exchanges.¹²

Economic Times (1999) reports that the Securities and Exchange Board of India has decided to allow stock exchanges to set up terminals at any place in the country. The move breaks the monopoly enjoyed by the National Stock Exchange.¹³

The Varma Committee (1999) set up by the Securities and Exchange Board of India to review badla or the carry forward system has recommended the need for bringing in stiffer norms, especially in the position limits of brokers. The committee claims that the daily badla is viable though it entails increased brokerage cost.¹⁴

¹³ “SEBI allows all SEs to set up terminals nation wide”, Economic Times, Mumbai, October, 9, 1999, p.3.
Vijay P.N. (2000), a Delhi based investment banker speaks about the impact of Internet based trading on stockbrokers. He says that the losers are really going to be stockbrokers and information providers. We have already seen how screen based trading reduced brokerage from up to 2 per cent a few years ago to less than 0.5 per cent now. When Internet based trading gets fully under way a stockbroker may get totally disintermediated. The same might be the case with database companies, which ask us to pay for information.15

In an interview to Rajeswari Adappa Thakur, SEBI’s executive director Pradip Kar (2000) speaks in favour of ‘rolling settlement’. Rolling settlement reduces market risk considerably. It gives greater liquidity to money because the investor gets his or her money/securities faster. The movement from account period settlement to rolling settlement is a major transformation for any market. He further adds that such a kind of shift is bound to cause some pain, so they are trying to bring about reforms in as painless a way as possible, as it was done in the case of dematerialisation16

Jaganathan K.T. (2000) examines the role of regional stock exchanges in a liberalised technology-driven economy. He states that

over a period, we can surely see a consolidation of the sort happening in the corporate world occurring in the Indian Stock Market as well. A stage will come where the regional exchange will either die a natural death or become appendages to bigger bourses – the BSE and the NSE. With broking becoming a resource intensive business, this should go a long way in helping the cause of the regional brokers. Jaganathan warns that there is however a danger in this. Now that they are given the opportunity to trade on bigger bourses (because of alliances between bourses), brokers of these regional exchanges may tend to focus less on local bourses – resulting in shrinkage of business to the regional bourses. That could spell further trouble for these exchanges.17

Indicating the role of banks in the stock market, Puneet Jain (2000), suggests that the Government must allow banks to participate in carry forward financing on the stock exchanges.18

Narasimham C.R.L. (2000) is of the view that the principal cause of the extra-ordinary volatility in the recent stock market behaviour has been the almost cartel type operation by operators and brokers.19

Oommen A. Ninan (2000) cautions that Nasdaq is controlling the Indian Stock Market. He further adds that eight per cent circuit breaker has also played its role in violent price fluctuations of shares. “The diabolical role played by the eight per cent circuit breaker can hardly be over emphasised. The authorities must seriously sit up and alter this much abused system, which has only helped manipulation”, he quipped.20

Abhijit Roy (2000) discusses the role of Foreign Institutional Investors in the Indian Capital Market. Over the years different types of FIIs have been allowed to operate in Indian stock markets. They now include institutions such as pension funds, mutual funds, investment trusts, asset management companies, institutional portfolio managers, university funds, endowments, charitable trusts, etc. There are approximately 500 FIIs registered with the SEBI, but not all of them are active. The FIIs have been playing a major role in the Indian capital market with cumulative investments having reached $11.24 billion by March end 2000.21

Parul Monga (2000) reports that the SEBI Committee set up for uniform rules and byelaws has recommended the need for minimum educational qualification for a person to be eligible to become a member of a stock exchange. In the opinion of the Committee he or she should be a graduate from a recognised University from any

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discipline or such higher qualification as prescribed by the governing board of the stock exchange.

The Committee also recommended that if a broker fails to trade for a minimum period of 50 trading days in a financial year, he shall be deemed to be an inactive member. If he fails to activate his membership card in two years, he renders himself liable for termination of his membership rights and the governing board of the exchange may extinguish the membership rights of such a member.22

Satish D (2000) speaks about 'e-broking'. "The Internet has revolutionised the brokerage industry. Online brokerage has grown substantially over the last six months". He further states that with the emergence of e-broking, which offers many benefits like, level playing field to all investors, comfort of the house, simplicity, low brokerage charges and value added services, it could be possible for some of the offline trade to shift to online trade. More importantly online broking is said to have brought in a whole new segment of investors who did not have a dedicated broker.23

Clifford Gomez (2000), in his book 'Capital Market and Financial Services', writes about the establishment of National Stock Market System. The process was initiated with the appointment of a

high-powered study group under the Chairmanship of Shri. M.J. Pherwani. They were to study the need for the establishment of new stock exchanges and review the operations of the existing ones in India. It identified major areas of concern which affected directly the interest of the investor: (a) Lack of liquidity (b) Lack of infrastructure (c) Inefficient and out-dated trading system (d) out dated settlement system and (e) Lack of a single market.

The study group observed that the setting up of additional stock exchanges would not serve the purpose of spreading the equity cult or enhancing liquidity in the secondary market. They recommended an integrated national market system with a three-tier market structure.

i. Principal stock exchanges comprising of the major stock exchanges at Bombay, Delhi, Calcutta, Madras and Ahmedabad.

ii. Regional Stock Exchanges comprising of other exchanges.

iii. Additional trading floors sponsored and managed by either principal stock exchanges or regional stock exchanges.

They also recommended the establishment of several support agencies to provide uniform and high quality trading, settlement, clearing and depository services.24

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Shankar V (2000), Joint Managing Director of Inter-connected Stock Exchange of India Ltd. speaks about the issues involved in the globalisation of stock exchanges. Stock exchanges have traditionally been set up as mutual organisations, i.e., members who own the exchange are also its customers. As such, a merger or take-over is possible only when the stock exchanges are de-mutual bodies. For the global exchange to become a reality, cross border listing of companies is essential. Again, if the global exchange has to allow buyers and sellers from different nations to transact online with one another, market timings would have to span multiple time zones.

He further states that cross border trading will be effective only if it is supported by cross border settlement. A global stock exchange can be built only on the formation of a strong global regulatory environment.25

Sanjay Kular (2000), reports that brokerages are facing more competition. Increasing competition, coupled with a sharp fall in brokerage rates, is giving the Indian stock-broking industry a tough time. He cautions the broking community by stating that the scope for increasing the volume of trade in the market is also diminishing fast with most brokerage houses already making their presence felt in the smaller towns. “Stockbrokers who offer clients the best advisory

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services, backed by strong research products and help them make gains will be positioned to charge higher rates”, said Shankar Sharma, Director, First Global Securities.26

Mayya M.R. (2000) expresses his opinion about speculation. “It is not appreciated that speculation plays a positive, constructive, economic role in stock markets, as in other markets”. He further observes that it is not true to say that a higher level of speculative activity would lead to greater volatility in prices as every purchase has to be matched by a sale and vice versa.27

Writing about the stock-broking profession Pratibha Gadhalay (2000) states that it involves tremendous work pressure as the commodity being traded concerns large volumes of money. It is a profession with a high-risk profile than others because professional growth depends on the share market, over which one has little control.28

Pattabiraman R (2001) expresses his views on the need for Professional Indemnity Insurance for stockbrokers. The professional indemnity insurance will insure professionals against losses that they may incur on account of awards by courts in suits for professional

negligence. He further points out that given the growth in internet trading and the need for engaging the services of professionals, it is likely that some investors may sue professionals for any deficiency in service. In that case professional indemnity insurance will come to the rescue of the brokers against the risk of incurring liability to third parties.29

Oommen A Ninan (2001) speaks about the need for preventing brokers from running the stock markets. He is of the view that the Government and the Securities and Exchange Board of India should speed up the demutualisation or corporatisation of the broker-driven stock exchanges. He feels that if the brokers are allowed to run the stock exchanges, there would be conflict of interest and the recent developments like the payment crises will be repeated in future also.30

Gupta LC (2001) points out that the underlying reason for the basic infirmities and proneness to crises of the Indian Markets is that the overall regulatory framework is still not right. It relies heavily on adhoc measures. He feels that the most serious deficiency arises from the failure to implement the rolling settlement system. He further adds that in the absence of a rolling settlement system, and that too when different exchanges have been allowed to have different settlement cycles, many speculators have really become dare-devil market

operators. He observes that another factor facilitating rampant price manipulation in India is the failure on the part of the SEBI to evolve a long-term regulatory policy towards short selling.31

Narasimhan C.R.L. (2001) is of the view that the recent measures announced by the Finance Minister in the Rajya Sabha to correct the malfunctioning of the stock market, namely: (a) Corporatisation of all stock exchanges, (b) extension of the rolling settlement for 200 category A stocks and (c) greater powers to the SEBI, did not make any immediate impression on the stock prices. He further points out that such major initiatives are announced only in the face of a market crisis.32

Yassir A Pitalwalla (2001) opines that the drop in volumes caused by the hike in margins and the ban on naked short sales imposed by the SEBI recently has begun to take its toll on the smaller stock exchanges. "Though the decline in turnover in the case of smaller exchanges may be lower in percentile terms than that on the BSE and NSE, the drop in volumes has a disproportionate effect on their viability, due to the high fixed costs of running a smaller exchange and the sensitivity of volumes to profitability", he says.33

Much has been written and spoken of in the last many years by writers about stock market and in particular about stock-broking. While some amount of literature is available on stock market practices and related problems, the researcher has not come across a detailed and scientific study of stock-broking. The review reveals that the brokers have numerous problems, which need immediate attention and solution. In the absence of a comprehensive study, often the corrective decisions are delayed or not taken by the Authorities. Hence the researcher feels that there is the need for a deep, analytical and scientific study on the topic of the problems and prospects of stock-broking in Kerala.