Chapter One

INTRODUCTION

1.1 Background to the Study

The Financial System of any economy consists of financial markets, financial intermediation and financial instruments or financial products. The economic development of any nation is reflected by the progress of the various economic units, broadly classified into corporate sector, government and household sector. In attempting to perform their activities, these units are always placed in a surplus/deficit/balanced situation, which gives rise to the process of lending and borrowing. There are units or people with surplus funds and there are those with a deficit. A financial system or financial sector functions as an intermediary and facilitates the flow of funds amongst the various units. People from the areas of surplus provide funds to the areas of deficit. It forms the economic foundation of an economy and it is a composition of various institutions, markets, regulations and laws, practices, money managers, analysts, transactions, claims, assets and liabilities. The word "system", in the term "financial system", implies a set of complex and closely connected or interlined financial institutions, agents, practices, markets, transactions, claims, assets and liabilities in the economy helping to facilitate the movement of funds in order to enhance development. The economic development of any nation, is therefore, reflected by the progress of the various economic units, broadly classified into corporate sector, government and the household sector. They contribute to the economic growth by providing funds and encouraging investment and other sustainable activities.

A financial system (Fig. 1.1), performs the following functions in order to provide growth and sustainability to the economy:

(i) It serves as a link between savers and investors. It helps in utilizing the mobilized savings of scattered savers in all the communities in a more efficient and effective manner. It provides a central pool of funds which can be carefully channeled towards productive investment.
(ii) It assists in the selection of the projects to be financed and also reviews the performance of such projects periodically, making sure that funds are not wasted on unprofitable investments.

(iii) It provides a payment mechanism for the proper exchange of goods and services.

(iv) It provides a mechanism for the transfer of resources across geographic boundaries, from zones with surpluses to zones where funds are scarce and needed for profitable investments.

(v) It provides a mechanism for managing and controlling the risk involved in mobilizing savings and allocating credit.

(vi) It promotes the process of capital formation by bringing together the supply of savings and the demand for investible funds.

(vii) It helps in lowering the cost of transaction and increases returns. It also helps in reducing the cost of funds and motivates the people to save more.

(viii) It provides the detailed information to the operators/players in the market such as individuals, business houses, Governments and creditors to help them decide on future investment opportunities.
The Financial System is concerned about money, credit and finance - the three terms are intimately related yet they are somewhat different from each other. The following are the four main components of Indian Financial system:

1. Financial Institutions
2. Financial Markets
3. Financial Instruments/Assets/Securities

(1) Financial Institutions
Financial institutions are the intermediaries who facilitate smooth functioning of the financial system by creating a link between savers and borrowers. They mobilize savings of the surplus units and allocate them in productive investments promising a better rate of return. Financial institutions also provide services to entities seeking advice on various issues ranging from restructuring to diversification of investments. They provide a whole range of services to the entities who want to raise funds from the markets and elsewhere. Financial institutions act as financial intermediaries, because they act as middlemen between savers and borrowers. These financial institutions may be of Banking or Non-Banking institutions.
(2) Financial Markets
Finance is a prerequisite for modern business and financial institutions play a vital role in economic systems. It is through the help of financial markets that the financial system of an economy works. The main functions of financial markets are:
(a) to facilitate creation and allocation of credit and liquidity;
(b) to serve as intermediaries for mobilization of savings;
(c) to assist process of balanced economic growth;
(d) to provide financial convenience
A Financial Market can be defined as the situation in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves the creation or transfer of a financial asset. Financial Assets or Financial Instruments represent claims to the payment of a sum of money sometime in the future and/or periodic payment in the form of interest or dividend. The financial market has four main components, namely: (i) the money market, (ii) the capital market, (iii) foreign exchange market and (v) the credit market

(i) Money Market - the money market is a wholesale debt market for low-risk, highly-liquid, short-term instrument. Funds are available in this market for periods ranging from a single day up to a year. This market is dominated mostly by government, banks and financial institutions.

(ii) Capital Market - the capital market is designed to finance the long-term investments of the economy. The transactions taking place in this market will be for periods over a year.

(iii) Foreign Exchange Market - the Foreign exchange market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the exchange rate that is applicable, the transfer of funds takes place in this market. This is one of the most developed and integrated market across the globe.

(iv) Credit Market - Credit market is a place where banks, FIs and NBFCs purvey short, medium and long-term loans to corporate and individuals.

(3) Financial Instruments
There is another important constituent of the financial system, they are financial
instruments. They represent a claim against the future income and wealth of others. It will be a claim against a person or an institution, for the payment of money at a specified future date.

**4) Financial Services**

Efficiency of an emerging financial system (the Indian financial system) largely depends upon the quality and variety of financial services provided by financial intermediaries. The term financial services can be defined as "activities, benefits and satisfaction connected with the sale of money that offers to users and customers, financial related value".

When financial instruments are designed, the issuer should ensure that these financial assets reach the ultimate investor in order to garner the requisite amount. When the borrower in need of funds approaches the financial market to raise funds, the mere issue of securities will not suffice. Adequate information of the issue, the issuer and the security should be carefully prepared and understood by the parties before fund raising can take place. There should be a proper channel within the financial system to ensure that the proper procedures are followed. To serve this purpose, financial intermediaries come into existence. Financial intermediation in the organized sector is conducted by a wide range of institutions, functioning under the overall surveillance of the Securities and Exchange Board of India and the Reserve Bank of India. In the initial stages, the role of the intermediary was mostly related to ensure transfer of funds from the lender to the borrower. This service was offered by banks, financial institution, brokers, and market dealers. However, as the financial system widened along with the developments taking place in the financial markets in India, the scope of its operations has also widened. Some of the important intermediaries operating in the financial markets include; investment bankers, underwriters, stock exchanges, registrars, depositaries, custodians, portfolio managers, mutual funds, financial advertisers, financial consultants, primary dealers, satellite dealers, self-regulatory organizations, etc. Though the markets are different, there may be a few intermediaries offering their services in more than one market e.g. underwriters, the services they offer vary from one market to another, (see Table 1.1).
Table 1.1: Markets and Intermediaries in the India Economy

<table>
<thead>
<tr>
<th>Intermediary</th>
<th>Market</th>
<th>Role</th>
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<tbody>
<tr>
<td>Stock Exchange</td>
<td>Capital Market</td>
<td>Secondary Market securities</td>
</tr>
<tr>
<td>Investment Bankers</td>
<td>Capital Market,</td>
<td>Corporate advisory services, Issue of securities</td>
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<tr>
<td></td>
<td>Credit Market</td>
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<tr>
<td>Underwriters</td>
<td>Capital Market,</td>
<td>Subscribe to unsubscribed portion of securities</td>
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<tr>
<td></td>
<td>Money Market</td>
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<tr>
<td>Registrars, Depositories, Custodians</td>
<td>Capital Market</td>
<td>Issue securities to the investors on behalf of the company and handle share transfer activity</td>
</tr>
<tr>
<td>Primary Dealers</td>
<td>Money Market</td>
<td>Market making in government securities</td>
</tr>
<tr>
<td>Satellite Dealers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Exchange Dealers</td>
<td>Foreign Exchange Market</td>
<td>Ensure exchange in the various currencies</td>
</tr>
</tbody>
</table>

**Source:** Internet Search (2010)

(a) Money Market Instruments

The money market can be defined as a market for short-term money and financial assets that are near substitutes for money. The term short-term means generally a period of up to one year. The instruments used in the money market are near substitutes to money. They are financial assets which can be quickly converted into money with minimum transaction cost.

Some of the important money market instruments are briefly discussed below:

1. Call/Notice Money
2. Treasury Bills
3. Term Money
4. Certificate of Deposit
5. Commercial Papers
(1) Call /Notice-Money

Call/Notice money is the money borrowed or lent on demand for a very short period. When money is borrowed or lent for a day, it is known as Call/Overnight Money. Intervening holidays and/or Sunday are excluded for this purpose. Thus money, borrowed on a day and repaid on the next working day, (irrespective of the number of intervening holidays) is "Call Money". When money is borrowed or lent for more than a day and up to 14 days, it is "Notice Money". No collateral security is required to cover these transactions.

(2) Inter-Bank Term Money

Inter-bank market for deposits of maturity beyond 14 days is referred to as the term money market. The entry restrictions are the same as those for Call/Notice Money except that, as per existing regulations, the specified entities are not allowed to lend beyond 14 days.

(3) Treasury Bills.

Treasury Bills are short term (up to one year) borrowing instruments of the union government. It is an IOU of the Government. It is a promise by the Government to pay a stated sum after expiry of the stated period from the date of issue (14/91/182/364 days i.e. less than one year). They are issued at a discount to the face value, and on maturity the face value is paid to the holder. The rate of discount and the corresponding issue price are determined at each auction.

(4) Certificate of Deposits

Certificates of Deposit (CDs) is a negotiable money market instrument, issued in dematerialised form or as a Usance Promissory Note, for funds deposited at a bank or other eligible financial institution for a specified time period. Guidelines for the issue of CDs are presently governed by various directives issued by the Reserve Bank of India, as amended from time to time. CDs can be issued by (i) scheduled commercial banks excluding Regional Rural Banks (RRBs) and Local Area Banks (LABs); and (ii) select all-India Financial Institutions that have been permitted by RBI to raise short-term resources within the umbrella
limit fixed by RBI. Banks have the freedom to issue CDs depending on their requirements. A Financial Institution (FI) may issue CDs within the overall umbrella limit fixed by RBI, i.e., issue of CD together with other instruments viz., term money, term deposits, commercial papers and inter-corporate deposits should not exceed 100 per cent of its net owned funds, as per the latest audited balance sheet.

(5) Commercial Papers

A Commercial Paper (CP) is a note in evidence of the debt obligation of the issuer. On issuing a commercial paper the debt obligation is transformed into an instrument. A Commercial Paper is, thus, an unsecured promissory note privately placed with investors at a discount rate to face value determined by market forces. A Commercial Paper is freely negotiable by endorsement and delivery. A company shall be eligible to issue Commercial Papers provided:

(i) the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs. 4 crore;

(ii) the working capital (fund-based) limit of the company from the banking system is not less than Rs.4 crore and

(iii) the borrower’s account of the company is classified as a Standard Asset by the financing banks. The minimum maturity period of CP is 7 days. The minimum credit rating shall be as determined by market forces or such equivalent rating by other agencies in India.

(b) Capital Market Instruments

The capital market generally consists of a long term period, that is, more than one year period, financial instruments; in the equity segment, Equity shares, preference shares, convertible preference shares, non-convertible preference shares etc. and in the debt segment debentures, zero coupon bonds, deep discount bonds etc.

(c) Hybrid Instruments

Hybrid instruments have both the features of equity and debenture. This kind of instruments is called as hybrid instruments. Examples are convertible debentures, warrants etc.
In India, the money market is regulated by the Reserve bank of India (www.rbi.org.in) and Securities Exchange Board of India (SEBI) [www.sebi.gov.in] regulates the capital market. The Capital market consists of primary market and secondary market. All Initial Public Offerings comes under the primary market and all secondary market transactions dealings are in the secondary market. The secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. The secondary market comprises of the equity markets and the debt markets. In the secondary market transactions BSE and NSE play a very significant role in the exchange of capital market instruments. The Securities and Exchange Board (SEBI) is the umbrella body overseeing the smooth functioning of the Indian Financial System. Hence, the responsibility for regulating the financial system is jointly shared by the Department of Economic Affairs (DEA), the Ministry of Company Affairs (MOCA), SEBI and the Reserve Bank of India (RBI). The activities of these agencies are carefully co-ordinated by a high level Committee on Capital and Financial markets. The orders of SEBI under the securities laws are appealable before the Securities Appellate Tribunal. SEBI is the regulator for the corporate debt market and investments in debt instruments by FIIs are also under the supervisory eye of SEBI. SEBI gets involved whenever there is any entity raising money from the Indian Capital Market. It has to make ensure that there is fair play for the retail investors. SEBI therefore, is charged with the protection of investors and regulating the market, making sure that there is growth and development.

1.2 The Pre-reforms Phase of the Indian Economy

Until the early 1990s, the role of the financial system in India was primarily restricted to the function of channeling resources from the surplus to deficit sectors. Whereas the financial system performed this role reasonably well, its operations came to be marked by some serious deficiencies over the years. The banking sector suffered from lack of competition, low capital base, low Productivity and high intermediation cost. After the nationalization of large banks in 1969 and 1980, the Government-owned banks dominated the banking sector. The role played by innovation and technology was minimal and the quality of service was not given significant importance. The Indian Banks at the time did not follow proper risk management systems and the prudential standards were weak coupled with the fact that corporate governance was still in its rudimentary stage. All these resulted in poor asset
quality and low profitability, which was not at all motivating to foreign investors. Among non-banking financial intermediaries, development finance institutions (DFIs) operated in an over-protected environment with most of the funding coming from assured sources at concessional terms. It was again less motivating investors who were more risk averse. In the insurance sector, there was little competition, since risk factors overshadowed the capital market environment. The mutual fund industry also suffered from lack of competition and was dominated for decades by one institution, viz., the Unit Trust of India, was the lone player. Non-banking financial companies (NBFCs) grew rapidly, but there was no regulation of their activities. Financial markets were characterized by control over pricing of financial assets, barriers to entry, high transaction costs and restrictions on movement of funds/participants between the market segments. This, however, apart from inhibiting the development of the markets also affected their efficiency.

1.3 Financial Sector Reforms in India

It was in this backdrop that wide-ranging financial sector reforms in the Indian economy were introduced as an integral part of the economic reforms initiated in the early 1990s in an attempt to improving the macroeconomic performance of the economy. The reforms in the financial sector focused on creating efficient and stable financial institutions and markets. The approach to financial sector reforms in India was one of gradual and progressive through a consultative process with all hands on deck. The Reserve Bank of India has been consistently working towards setting an enabling regulatory framework with prompt and effective supervision, development of technological and institutional infrastructure, as well as changing the interface with the market participants through a consultative and constructive process. Increasing efforts have been made towards the careful adoption of international benchmarks as appropriate to the Indian conditions. However, certain changes have been made in the legal infrastructure and in the development of the markets, which have so far brought the Indian financial system closer to global standards. The reform of the interest regime constitutes an integral part of the financial sector reform. With the onset of the financial sector reforms, the interest rate regime has been largely deregulated with a view towards better price discovery and efficient resource allocation. It is evident that from the 1990s, steps have been carefully taken to develop the domestic money and capital markets leading to the freeing of the money market rates and permitting the forces of demand and
supply to take the lead. The interest rates offered on Government securities were progressively raised, so that the Government borrowing could be carried out at market-related rates. However, in respect of banks, a major effort was undertaken to simplify the administered structure of interest rates. The Banks now have sufficient flexibility in making decisions as to their deposit and lending rate structures and to manage their assets and liabilities accordingly. At present, apart from savings account and NRE deposit on the deposit side and export credit and small loans on the lending side, all other interest rates are deregulated. The Indian banking system operated for a long time with high reserve requirements, both in the form of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). This was a consequence of the high fiscal deficit and a high degree of monetisation of fiscal deficit. The efforts in the recent period have been to lower both the CRR and SLR thereby making the money market more liquid. The statutory minimum of 25 per cent for SLR has already been reached. However, the Reserve Bank continues to pursue its medium-term objective of reducing the CRR to the statutory minimum level of 3.0 per cent.

In India, due attention has also been given to diversification of ownership leading to greater market accountability and improved efficiency and profitability. The Indian economy is very competitive, now, because during the 1990s, there was a gradual infusion of capital by the Government in the public sector banks. This was followed by expanding the capital base with equity participation by the private investors. This was followed again by a reduction in the Government shareholding in public sector banks to 51 per cent. Consequently, the share of the public sector banks in the aggregate assets of the banking sector have come down from 90 per cent in 1991 to around 75 per cent in 2008. The view has been to enhance efficiency and productivity through competition. As a result, guidelines were laid down for the establishment of new banks in the private sector and the foreign banks have been allowed more liberal entry, hence, this was great motivation for foreign investment. After 1993, twelve new private sector banks have been set up. This is a major step towards enhancing competition in the banking sector, foreign direct investment in the private sector banks is reckoned now to have been allowed at up to 74 per cent, subject to conformity with the guidelines issued from time to time.

The Indian financial system has undergone structural transformation over the past decade. The financial sector has acquired strength, efficiency and stability by the combined effect of
competition, regulatory measures, and the policy environment. It is evident that competition, consolidation, convergence and good corporate governance have been recognized as the key drivers of the Indian financial system. They have contributed very strongly to the Indian stable economy, making it more competitive.

1.4 Historical Events of the Indian Financial System

It is necessary to note the various significant events in the Indian Capital Market. In the early 19 century, the trading in shares of the East India Company was introduced in Kolkata and Mumbai. The joint company idea was introduced in the year 1850 and by the year 1860, speculation and feverish dealings started in securities. By the year 1875 the Bombay Stock Exchange was established followed by that of Ahmedabad in 1894. By 1908, it was the turn of the Calcutta Stock Exchange to be established. It was closely followed by Lahore and Madras Stock Exchange in 1937 and it took a period of ten years to get the next one established and that was the Delhi Stock Exchange in 1947. Dealing in shares became very popular and this led to the enactment of the Securities Contract Act, 1956.

In 1957, the first public scam surfaced known as the Scam of Hordas Mundhra. In an attempt to control the situation, the Government of India formed the securities and Exchange Board of India in 1988. By 1991, the Capital Market of India witnessed the second scam, known as the MS Shoes scam. These scams and other issues led to the enactment of the Securities and Exchange Board of India (SEBI) Act of 1992. While this was being done, the Harshad Mehta scam was cooking up and exploded in the year 1992. Further developments were witnessed, that is, the formation of the National Stock Exchange in 1993. By 1995, there was another scam called the SESA Goa scam. The Depositories Act was enacted in the year 1996, followed by two scams: the C.R. Bhansali scam, 1997 and the B.P.L. and Videocom scam, 1998. The Ketan Parekh took place in the year 2001, after that there was the abolishment of the badla trading system in 2002 and the introduction of the T+3 settlement system. By the year 2003 the T+2 settlement system was introduced. In the 2005, the Sensex unprecedentedly rose to 6954 points and by the 2006 it went up to 14,000 points. After a long spell, the Satyam surfaced in the year 2008 (see Appendix IV).
1.5 Recognised Stock Exchanges in the Indian Financial System

The Indian Stock Markets are one of the oldest in Asia. The history dates back to about 200 years. The earliest records of security dealings in India are meagre and obscure. The East India Company was the dominant institution in those days and business in its loan securities used to be transacted towards the close of the eighteenth century. By the 1830's business on corporate stocks and shares in Banks and Cotton presses took place in Bombay. Though the trading list was broader in 1839, there were only half a dozen brokers recognized by banks and merchants during 1840 and 1850. The 1850's witnessed a rapid development of commercial enterprise and brokerage business attracted many men into the field and by 1860 the number of brokers increased into 60. By 1860-61 the American Civil War broke out and cotton supply from United States to Europe was stopped; thus, the 'Share Mania' in India started. The number of brokers increased to about 200 to 250. However, at the end of the American Civil War, in 1865, a disastrous slump began; for example, the Bank of Bombay Shares which had touched Rs 2850 crashed to Rs. 87. At the end of the American Civil War, the brokers who thrived out of the Civil War in 1874 found Dalal Street where they conveniently assembled and transacted business. In 1875, they formally established in Bombay, the "Native Share and Stock Brokers' Association" (which is alternatively known as "The Stock Exchange"). In 1895, the Stock Exchange acquired a premise in the same street and it was inaugurated in 1899. Thus, the Stock Exchange at Bombay was consolidated and has been a leading Stock Exchange till date.

Ahmedabad gained importance next to Bombay with respect to cotton textile industry. After 1880, many mills originated from Ahmedabad and rapidly forged ahead. As new mills were floated, the need for a Stock Exchange at Ahmedabad was realised and in 1894 the brokers formed "The Ahmedabad Share and Stock Brokers' Association". What the cotton textile industry was to Bombay and Ahmedabad, the jute industry was to Calcutta. Also tea and coal industries were the other major industrial groups in Calcutta. After the Share Mania in 1861-65, in the 1870's, there was a sharp boom in jute shares, which was followed by a boom in tea shares in the 1880's and 1890's; and a coal boom between 1904 and 1908. On June 1908, some leading brokers formed "The Calcutta Stock Exchange Association". In the beginning of the twentieth century, the industrial revolution was on the way in India with the Swadeshi
Movement; and with the inauguration of the Tata Iron and Steel Company Limited in 1907 and an important stage in industrial advancement under the Indian enterprise was witnessed. In 1920, the then modest city of Madras had the maiden thrill of a stock exchange functioning in its midst, under the name and style of "The Madras Stock Exchange" with 100 members. However, when the boom faded, the number of members stood reduced from 100 to 3, by 1923, and so it went out of existence, giving to the formation of the M.P. Stock Exchange in 1930. By 1935, the stock market activity improved, especially in South India where there was a rapid increase in the number of textile mills and many plantation companies were floated. By 1937, the Madras Stock Exchange again resurfaced, now known as Madras Stock Exchange Association (Pvt) Limited.

The Uttar Pradesh Stock Exchange Limited (1940), Nagpur Stock Exchange Limited (1940) and Hyderabad Stock Exchange Limited (1943) were incorporated. In Delhi two stock exchanges - Delhi Stock and Share Brokers' Association Limited and the Delhi Stocks and Shares Exchange Limited - were floated and later in June 1947, amalgamated into the Delhi Stock Exchange Association Limited. The Bangalore Stock Exchange Limited was registered in 1957 and recognized in 1963. Most of the other exchanges languished till 1957 when they applied to the Central Government for recognition under the Securities Contracts (Regulation) Act, 1956. Only Bombay, Calcutta, Madras, Ahmedabad, Delhi, Hyderabad and Indore, the well-established exchanges, were recognized under the Act. Some of the members of the other Associations were required to be admitted by the recognized stock exchanges on a concessional basis, but acting on the principle of unitary control, all these pseudo stock exchanges were refused recognition by the Government of India and they thereupon ceased to function. Thus, by the 1997 there were twenty-four recognized stock exchanges in India. The Cochin Stock Exchange (1978), Uttar Pradesh Stock Exchange Association Limited (at Kanpur, 1982), and Pune Stock Exchange Limited (1982), Ludhiana Stock Exchange Association Limited (1983), Gauhati Stock Exchange Limited (1984), Kanara Stock Exchange Limited (at Mangalore, 1985), Magadh Stock Exchange Association (at Patna, 1986), Jaipur Stock Exchange Limited (1989), Bhubaneswar Stock Exchange Association Limited (1989), Saurashtra Kutch Stock Exchange Limited (at Rajkot, 1989), Vadodara Stock Exchange Limited (at Baroda, 1990), Meerut Stock Exchange (1991), the

1.6 The Purpose of the Securities and Exchange Board of India in the Financial System

The 1980s boom revealed the insufficiency of the Capital Issues Act and this situation gave birth to the Securities and Exchange Board of India (SEBI) in 1988. The Government of India issued an ordinance on January 30, 1992 giving statutory powers to the Securities and Exchange Board of India. The Act was passed by the Indian Parliament, Act Number 15 of 1992. This Act received the assent of the Indian Parliament on 4th April, 1992. As a result of Act Number 15 of 1992 being enacted, the Capital Issues Control Act of 1947 was abolished.

The Act of 1992 established the Securities and Exchange Board of India. The purpose of this Board was laid down in its preamble as follows:

(a) To protect the interests of investors in the Securities Market.
(b) To promote the development of the Securities Market.
(c) To regulate the Securities Market, and
(d) For matters connected therewith or incidental thereto.

The Board brought into force regulations governing the functioning of the Securities Market in relation to trading, clearing, settlements, depositories, capital adequacy norms, margining, Stock Exchanges and their role, equity financing, dematerialization and the custody services. Subsequent to the enactment of the SEBI Act, 1992, the following regulations have been framed over the years:


(iv) The Securities and Exchange Board of India, (Depositories and Participants) Regulations, 1996.


These regulations set out the basic framework and guidelines for operations of the Stock Exchanges and all the related intermediaries. The regulations are suitably modified from time to time.

The Securities and Exchanges Board of India (SEBI) has adopted many important roles in the area of policy formulation, regulation, enforcement and market development. SEBI ensures that it vets every element of the Capital Market reforms, designed in India. It attempts enforcements against problems such as market manipulation and payment crises, and is the overseer of all market intermediaries. In late 1993, SEBI banned badla. This was a major milestone in two respects:

(a) It marked the commencement of a major role for SEBI, and
(b) It curtailed the market manipulation and systemic risk that accompanied badla.

1.7 The Members of the Indian Financial System

The Indian financial system comprises a set of financial institutions, financial markets and financial infrastructure. The financial institutions mainly consist of commercial and co-operative banks, regional rural banks (RRBs), all-India financial institutions (AIFIs) and non-banking financial companies (NBFCs). The banking sector which forms the bedrock of the Indian financial system falls under the regulatory ambit of the Reserve Bank of India (RBI), under the provisions of the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934. The Reserve Bank also regulated the AIFIs. Consequent upon the amendments to the Reserve Bank of India Act in 1997, a comprehensive regulatory framework in respect of NBFCs was put in place in January 1997. The financial market in India comprises the money market, the Government securities market, the foreign exchange market and the capital market. A holistic approach has been adopted in India towards designing and developing a modern, robust, efficient, secured and integrated payment and settlement system. The
Reserve Bank of India set up the Institute for Development and Research in Banking Technology (IDRBT) in 1996, which is an autonomous centre for technology capacity building for banks and providing core IT services. The other members of this sector are the Mutual funds which are seen as institutions for providing small investors with avenues of investment in the capital market and the venture capital funds (also known as VC or Venture Capital) which is a type of private equity capital typically provided for early-stage, high-potential, growth companies in the interest of generating a return through an eventual realization event such as an IPO or trade sale of the company, (Appendix VII).

1.8 Objectives of the Study

This research study revolves on the axis of five objectives which are carefully outlined hereunder:

(1) To study and evaluate the functions (the provision of a safe investment environment and the development of the Securities Market) of the Securities and Exchange Board of India (SEBI) in the Indian Capital Market.

(2) To study the degree of riskiness present in the Indian Capital Market.

(3) To study the performance of selected companies listed on the Indian Capital Market between the period 1992 and 2006.

(4) To study the implementation of the Corporate Governance principles by the selected companies as required by SEBI.

(5) To study brokers and investors’ perception about SEBI and its performance in the Indian Capital Market.

1.9 Need of the Study

The Securities and Exchange Board of India (SEBI) is a government organisation with independent powers set up to control and regulate the Securities Market in India. Despite the activities and functioning of the Board, there are still a lot of malpractices, insider trading and rosy pictures presented by managers to investors about the security of investments, in the
form of high dividends and capital gains which actually do not exist. This is posing a big
problem to investors and to SEBI. Therefore, there are lots of risks in the Indian Capital
Market which investors should watch out for. There is a need to carefully quantify the risks
for the benefit of the investors. Is SEBI doing enough to reduce these risks in order to protect
the investors?

The importance of this research work is that it will serve as an eye opener to investors,
revealing the enormous work that SEBI is doing in order to offer them the protection that
they need, in the vulnerable environment of the Securities Market. The study will help the
Cameroon Government in strengthening its newly opened stock market - the Douala Stock
Exchange in Cameroon. It is still in its infancy stage, lacking in both infrastructure and
management expertise. This research will also be useful to other African countries having
problems in the regulation of their Securities Markets

1.10 Scope of the Study

This research study is based on the Securities and Exchange Board of India (SEBI), on its
activities in the protection of investors in the Indian Capital Market. This study covers the
period 1992 to 2006. The literature review covers up to the year 2010. The study
concentrates basically on capital issues – shares and debentures and capital transfers in the
Securities Markets. The focus is on the investors’ protection. In order to achieve the
investors’ protection aspect, the study looks at Corporate Governance and risk management
activities carried out by SEBI in the Capital Market environment.

1.11 Chapterisation of the Study

The study has been divided into nine chapters. It includes the bibliography which is closely
followed by appendices:

Chapter one - Introduction

Chapter two - Literature review

Chapter three - Research Methodology

Chapter four - The Indian Capital Market and Risk Management Therein
This chapter has presented the introduction to this research work. This leads to chapter two where the literature review is carefully presented. The literature review provides a reason as to why this research was necessary.