CHAPTER III
STOCK EXCHANGES IN INDIA

3.1 INTRODUCTION

Stock Exchange is an organised market for purchase and sale of listed securities, viz., Loan bonds, Debentures and Shares. The Securities issued by the Central Government, the State Governments, Public bodies and the Joint stock companies are traded in the stock exchanges. The Securities Contracts (Regulation) Act 1956 defines a Stock Exchange as,

"an association, organisation or body of individuals whether incorporated or not, established for the purpose of assisting, regulating, and controlling business in buying, selling and dealing in securities."

Stock Exchanges are often called the 'barometers', meaning that they indicate the general condition of the atmosphere of business. They provide useful service to the society. Some of their important functions may be briefly summed up as follows:

i) Providing a ready market for the purchase and sale of securities, and ensuring liquidity and price continuity.

ii) Providing a measure of safety in dealings.

iii) Evaluating securities through open market appraisal.

iv) Mobilising and channelising the capital.

v) Safeguarding the interests of the investors through enforcement of rules and regulations and

vi) Providing facilities for healthy speculation.
3.2 HISTORY AND DEVELOPMENT

The first Stock Exchange in India was formally established at Bombay in 1875. But transactions in securities had begun much earlier. Records show transactions as early as the closing years of the 18th century. The second stock exchange was established at Ahmedabad in 1894. Then the Calcutta Stock Exchange was formed in 1908. During the 1930s, two more stock exchanges, one at Indore and another at Madras were established. During the next decade, two more stock exchanges, one each at Hyderabad and Delhi were established. The 1950s saw the birth of Bangalore Stock Exchange. After a lull of about two decades, the next stock exchange was established at Cochin in 1978. Thus, over a period of 100 years, between 1875 and 1978, nine Stock Exchanges were established. During the 1980s, in just nine years, between 1982 and 1990, ten new Stock Exchanges have come into existence at Kanpur, Pune, Ludhiana, Guwahati, Mangalore, Patna, Bhubaneshwar, Jaipur, Rajkot and Vadodara. There are at present nineteen stock exchanges in India.

The development pattern of the stock exchanges over the last 42 years, between 1946 and 1988, is given in Table 3.1.
<table>
<thead>
<tr>
<th>Name of the Stock Exchange</th>
<th>No. of listed companies</th>
<th>No. of issues listed</th>
<th>Paid up value (Cr.Rs.)</th>
<th>Equity</th>
<th>Pref.</th>
<th>Deb.</th>
<th>Total Market value of capital (Cr.Rs.)</th>
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<tbody>
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<td>4791</td>
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<td>715</td>
<td>3</td>
<td>1533</td>
<td>2251</td>
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<td>1800</td>
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<td>10</td>
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<td>671</td>
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<td>788</td>
<td>96</td>
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<td>1751</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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</table>

The Table shows the manifold increase in the number of stock exchanges, number of listed companies, number of issues listed, paid-up value of capital and the market value of capital between 1946 and 1988. As on 31st Dec., 1988, there are 5841 listed companies (companies listed in more than one stock exchange counted only once) in the 15 stock exchanges mentioned in the Table.

Of all the stock exchanges, Bombay Stock Exchange is the biggest and the premier stock exchange in the country. The capital listed in Bombay as on 31 December, 1988 accounted for 83 per cent of the overall capital listed on all the Stock Exchanges, whereas its share of market capitalisation amounted to 89 per cent as on the same date. In terms of the total number of companies and total number of stock issues listed also Bombay ranked first. It is roughly estimated that the turnover of the Bombay Stock Exchange is about 70 per cent of the overall turnover of all the Stock Exchanges in the country. While the Stock Exchanges at Bombay and Calcutta are the most active ones, those at Delhi, Ahmedabad and Madras follow them in the order of their importance. The other exchanges are relatively less important.

3.3 ORGANISATION:

The stock exchanges are organised in different ways. The Stock Exchanges at Bombay, Ahmedabad, and Indore are organised as voluntary non-profit making association of persons; those at Calcutta, Delhi, Cochin, Kanpur, Ludhiana, Guwahati and Mangalore function as public limited companies, and those at Madras, Hyderabad and Pune are companies limited by Guarantee. However, there is a broad unity
in the organisation of stock exchanges, since the Rules or Articles of Association defining the constitution of the recognised stock exchanges are approved by the Central Government.

3.3.1 Governing body:

Each stock exchange is managed by a governing body which is known by different names, such as Governing board, Committee, Council of Management and Board of Directors in different stock exchanges. The governing body of the Bombay Stock Exchange is the Governing Board.

3.3.1.1. Constitution:

The governing bodies comprise elected representatives of the share brokers, representatives of the Government and nominated members from the public. The President of the governing body is elected by the members, subject to the Government approval in major stock exchanges. The Executive Director is appointed/approved by the Government to ensure that the rules, regulations and directives of the Government are properly implemented, and the operations in the market are conducted in an orderly manner.

3.3.1.2. Powers:

The governing body of a recognised stock exchange has wide Governmental and administrative powers. It has the power, subject to the Government approval, to make, amend and suspend the operation of the rules and regulations of the exchange. It has jurisdiction over all the members. It has the power to supervise, direct and control all matters and activities affecting the stock exchange.
3.4. MEMBERS:

Only the members of the stock exchange are permitted to transact business in securities in a recognised stock exchange. Broadly, the members of the stock exchange perform two distinct functions:

a) that of a broker as an agent, buying and selling securities for customers on a commission basis,

b) that of a jobber as principal, dealing in securities on one's own account.

The bye-laws of the stock exchanges have not laid down any functional distinction between the members. A member can act both as a broker and a jobber. In practice, there appears to be a fairly well-established specialisation among members in the Bombay Stock Exchange on the following lines:

i) Commission Brokers: Those who execute contracts for sale and purchase on behalf of their clients on a commission basis.

ii) Floor Brokers: Those who execute orders for other members and receive a share of brokerage charged by the authorising members to their clients.

iii) Taravanivallas: Those who are jobbers or specialists who trade in active scrips on their own account.

iv) Dealers in non-cleared shares\(^2\): Those who specialise in shares of the non-cleared list.

v) Odd-lot\(^3\) dealers: Those who trade in odd-lot securities. They earn profit on the difference between the prices of purchases and sales.
vi) Budliwallas or financiers: Those who lend money or loan securities to the market in times of need. They charge interest for their services.

vii) Arbitraguer: Those who specialise in making purchases and sales in different markets at the same time, and profit by the difference in prices between two centres.

viii) Dealer in government securities: Those who specialise in buying and selling gilt-edged securities.

These categories are not mutually exclusive and tend to overlap. Depending upon the volume of business, specialisation in the above manner appears in other stock exchanges also.

3.5. REGULATION OF STOCK EXCHANGES:

The Securities Contracts (Regulation) Act 1956 regulates the activities of the stock exchanges and dealings in securities. The Act makes the general framework of control with wide powers to the Central Government.

The important objectives of the Act are:

i) To empower the Central Government to control the stock exchanges in India.

ii) To provide reasonable uniformity in respect of the rules and bye laws of the different stock exchanges.

iii) To ensure orderly and healthy development of the stock exchanges.

iv) To protect the interests of the investors and

v) To prevent unhealthy speculation and other undesirable activities in the stock exchanges.
3.5.1. Salient features of the Securities Contracts (Regulation) Act, 1956:

The Act contains proposals for accomplishing the aforesaid objectives. The points of the Act are summarised below.

i) Recognition of Stock Exchanges:

The Act permits only those stock exchanges which are recognised by the Central Government to function in any notified State or area. Recognition is granted to a stock exchange only when the Government is satisfied that:

a) Its rules and bye-laws conform to the conditions prescribed for ensuring fair dealings and protection of investors.

b) The stock exchange is willing to comply with such other conditions which the Central Government after consultations with the governing body may impose for the purpose of carrying on the objectives of the Act.

c) It would be in the interest of trade and also in the public interest.

ii) Withdrawal of recognition:

The Central Government has the power to make inquiries into the affairs of a stock exchange and its members, to supersede the governing body and to take over the properties of a recognised stock exchange, to suspend its business, and to totally withdraw recognition granted to a stock exchange in the interest of the trade and in the public interest.
iii) Submission of Returns, information etc., by Stock Exchange:

Every stock exchange is required to furnish to the Central Government such periodical returns relating to its affairs as may be prescribed. Every recognised stock exchange and every member is required to maintain such records as may be prescribed. Further the Central Government has the power to,

a) Call upon a recognised stock exchange or any member there of to furnish such explanation or information as the Government may require relating to the affairs of the stock exchange or any member.

b) Appoint one or more persons to make an enquiry into the affairs of the governing body or the affairs of any of its members.

iv) Rules and Bye-laws of Stock Exchanges:

The Rules of a recognised stock exchange relating in general to the constitution of the exchange, the powers of management of the governing body and its constitution (including the appointment thereon of not more than three Government nominees), the admission of members, the qualifications for membership, the supervision, expulsion and readmission of members, the registration of partnerships and the appointment of authorised representatives and clerks must be duly approved by the Government. These Rules can be amended, varied or rescinded only with the previous approval of the Government.
The Bye-laws of the recognised stock exchange providing in detail for the regulation and control of contracts in securities and for every aspect of trading activities of members must also be sanctioned by Government and any amendments or modifications must be similarly approved. The Government is empowered to make or amend ‘suo moto’ any Rules or Bye laws of a recognised stock exchange in the interest of the trade and in the public interest.

v) Appointment of licensed dealers:

Where there are no stock exchanges, the Act empowers the Government to grant license to dealers in securities and prescribe the conditions subject to which they carry on the business of dealing in securities.

vi) Illegal and void contracts:

In any notified state or area, all contracts in securities (other than spot delivery contracts) which are not entered into through, with or between members of recognised stock exchanges shall be illegal and punishable with fine or imprisonment or both.

In any notified state or area, all contracts in securities entered into in contravention of certain specified bye-laws of a recognised stock exchange shall be void and unenforceable at law.

vii) Prevention of undesirable speculation:

To prevent undesirable speculation, the Government is empowered to declare that no contract for the sale or purchase of specified securities shall be entered into in any notified state or
area except to the extent and in the manner prescribed in the notification.

Option business is totally prohibited. All options in securities are made illegal and are liable to be punished with fine and imprisonment. Blank transfers are discouraged.

viii) Listing regulation:

The Government has the authority to compel any public company to have its shares listed on a recognised stock exchange by complying with such requirements as may be prescribed for the purpose.

Any public limited company which has been refused listing facilities by a stock exchange has the right to appeal to the Central Government. The Central Government may vary the decision of the stock exchange.

3.5.2 Securities Contracts (Regulation) Rules, 1957

Under the Securities Contracts (Regulation) Act, the Central Government has promulgated the rules for carrying into effect the objectives of legislation. These rules provide among other things for:

i) the procedure to be followed for recognition of stock exchange;

ii) submission of periodical returns and annual returns by recognised stock exchange;

iii) inquiry into the affairs of a recognised stock exchange and their members; and
iv) requirements for listing of securities. These rules are statutory and constitute a code of standardised regulations uniformly applicable to all the recognised stock exchanges.

3.5.3 Directorate of Stock Exchanges:

To ensure effective compliance of the Government instructions to watch the affairs of the stock exchanges and to check unofficial dealings, a Directorate has been set up by the Government of India. The Directorate has its head office in Bombay. The Directorate acts as a link between the Central Government and the stock exchanges of the country.

3.6 SECURITIES TRADED

Gilt-edged securities and corporate securities are traded on the stock exchanges.

3.6.1 Gilt-edged Securities:

These securities are issued by the Central Government, State Governments, State Administrations, Municipalities, Improvement Trusts, Port Trusts and other public bodies. These securities are officially listed on the recognised stock exchanges as soon as they are issued by the authorities concerned. These securities are predominantly held by the institutional investors. Table 3.2 gives the outstanding amount of Central and State Government loans as at 31st Dec. 1988.
### TABLE 3.2

GILT EDGED SECURITIES  
(As at 31 Dec 1988)

<table>
<thead>
<tr>
<th>Central Government Loans</th>
<th>Amount (Cr.Rs.)</th>
<th>Amount (Cr.Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 5 years</td>
<td>4685</td>
<td></td>
</tr>
<tr>
<td>5-10 years</td>
<td>4691</td>
<td></td>
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<tr>
<td>Over 10 years</td>
<td>38454</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>47830</strong></td>
<td></td>
</tr>
</tbody>
</table>

| State Government Loans   | 8779            |                 |

| **Total (Central & State Govt. Loans)** | **56609** |


Inclusive of Rs.3000 crores loans outstanding of Local Authority and Central and State financial institutions' loans, the total amount outstanding of gilt-edged securities as at 31st December 1988 was around Rs.60000 crores.
3.6.2 Corporate Securities

The securities issued by the public limited companies are of two types: i) fixed income securities and ii) variable income securities. While preference shares and debenture bonds are fixed income securities, equity shares give variable dividends. Table 3.3 gives the paid up value of capital listed and the market value of capital listed of corporate securities, as on 31st December 1988.

**TABLE 3.3**

PAID UP AND MARKET VALUES OF CAPITAL LISTED

(As on 31st Dec. 1988)

<table>
<thead>
<tr>
<th></th>
<th>Paid up value (Cr.Rs.)</th>
<th>Market value (Cr.Rs.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity</td>
<td>10549</td>
<td>39133</td>
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<tr>
<td>Preference</td>
<td>176</td>
<td>158</td>
</tr>
<tr>
<td>Debentures/Bonds</td>
<td>10740</td>
<td>12088</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21465</strong></td>
<td><strong>51379</strong></td>
</tr>
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</table>


It is evident from the Table that the equity capital is predominant among the corporate securities. Preference shares account for a minor share only.

The growth pattern of listed stock is given in Table 3.4.
### TABLE 3.4
GROWTH PATTERN OF LISTED STOCK

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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
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<td>1. No. of listed companies</td>
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<td>1203</td>
<td>1852</td>
<td>5560</td>
<td>5841</td>
<td>419 386 215 5</td>
</tr>
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<td>2. No. of stock issues of listed companies</td>
<td>1506</td>
<td>2111</td>
<td>3230</td>
<td>7696</td>
<td>7694</td>
<td>411 264 138 0</td>
</tr>
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<td>3. Paid-up capital of listed companies (Cr. Rs.)</td>
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<td>753</td>
<td>2614</td>
<td>16888</td>
<td>21465</td>
<td>7850 2750 721 27</td>
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<td>4. Market value of Paid-up capital of listed companies (Cr. Rs.)</td>
<td>971</td>
<td>1292</td>
<td>3273</td>
<td>3521</td>
<td>51379</td>
<td>5191 3876 1469 45</td>
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<td>5. Paid-up capital per listed company (Lakh. Rs.)</td>
<td>24</td>
<td>63</td>
<td>141</td>
<td>304</td>
<td>367</td>
<td>1429 482 160 21</td>
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<tr>
<td>6. Market value of paid-up capital of listed companies (Lakh. Rs.)</td>
<td>86</td>
<td>107</td>
<td>177</td>
<td>639</td>
<td>880</td>
<td>923 722 397 38</td>
</tr>
</tbody>
</table>

Listed capital is estimated to be about 90 per cent of the capital of all non-government public limited companies. Over 1946-88, the value of listed capital increased by almost eighty times from Rs.270 crores to Rs.21465 crores. The total capital employed of Rs.21465 crores of 5841 listed companies is covered by 7694 stock issues, of which equity comprise 5882, preference issues 730 and debenture issues 1082. It is clear that the old listed companies are rapidly growing bigger and/or that the new companies admitted to the list are of considerably larger size than before.

3.7. TRANSACTIONS IN SECURITIES:

Business in the stock exchanges is done on an auction basis. There are separate trading posts for different groups of securities, at which business in such securities are primarily transacted. Bids and Offers are made aloud and the bargain is closed at a price mutually agreed upon. The bargains entered into are by word of mouth and all bargains are scrupulously honoured.

3.7.1 Types of Transactions:

Under the bye laws and regulations of recognised stock exchanges, transactions in listed securities may be for:

i) Spot delivery: delivery and payment on the same day as the date of contract or on the next day.

ii) Hand delivery: delivery and payment within the time or on the date stipulated when entering into the bargain, which shall not be more than 14 days following the date of contract.
iii) Clearing of the account: clearance and settlement through the clearing house.

iv) Special delivery: delivery and payment within any time exceeding fourteen days following the date of the contract as may be stipulated when entering into the bargain.

Business for spot delivery or hand delivery can be done in cleared as well as non-cleared securities, but business for the clearing can be done in cleared securities alone.

3.7.2. Delivery and Payment:

In Bombay, transactions in equity shares are generally for 14 day settlement, commencing from a Friday and ending a fortnight later. Purchases and sales made on any day of a given period may be crossed out by subsequent sales and purchases during the same period. All the outstanding bargains at the end of the period have to be settled by delivery and payment on the prescribed day.

After the last business day, all business done during the period is temporarily adjusted at making-up prices. Amounts due to or from members are determined on the basis of this price and payment made through the Clearing House.

Transactions in non-specified securities are for compulsory delivery, while carry-over is permitted only for specified shares. Delivery and payment for cleared securities is effected through the Clearing House. In the case of non-specified shares, the delivering member hands over the share certificates directly to the receiving member named in the delivery order.
3.8. PRESENT POSITION OF STOCK EXCHANGES:

Over the last four decades, there has been a significant widening and deepening of the Indian stock markets. "The quantum of new issues raised, on an annual average, rose from less than Rs.100 crores prior to the 1970's to Rs.1000 crores by 1980s and reached Rs. 4200 crores by 1986-87". The business in the secondary market has also multiplied in geometric proportions, having increased by over 100 times during the last four decades. "Indian stock exchanges with a market capitalisation of about Rs.25000 crores, which account for about 11 percent of the GNP, constitute one of the biggest markets in the emerging stock markets of the world."

But still, "... for a country of continental proportions (Europe minus Soviet Russia), and a population of 800 million, and a savings rate of 23-24 percent, one of the highest in the Third World, these stock exchanges look like plants in flower pots kept in drawing rooms rather than blooming trees in a vernal wood." The share of equity in the total household sector saving is only 6 per cent compared to 25 to 30 per cent in the Western countries. Still there is a tremendous scope for further expansion of stock markets in this country.

3.9. RECENT DEVELOPMENTS IN STOCK MARKETS:

During the recent past, certain welcome changes have taken place in the Indian stock exchanges. Computerisation has begun on a modest scale; stock scan facility provides simultaneous display of quotations of selected shares in major centres; facilities to trade in odd-lot shares have been created and so on.
To regulate the activities of the stock exchanges and for the healthy growth of the capital market, Securities and Exchange Board of India (SEBI) has been set up. As the apex institution, this Board seeks to provide investor protection, enforce disclosure of information, monitor the activities in the market and check insider trading and speculation.

Public Financial Institutions and banks have evolved mutual fund schemes and shares of these funds are quoted on the stock exchanges. Companies, financial institutions and banks have been allowed to become members of the stock exchanges. Government companies raise loans in the primary market. New instruments like commercial paper and warrants are being introduced. Customers’ protection fund to take care of the legitimate investment claims of the clients of a defaulting broker, has been established in the Bombay Stock Exchange.

In the primary market, several large issues of over Rs.100 crores each are being floated and are rapidly absorbed in the market. Companies are evolving safety nets to buy-back the residual portions after conversions of the convertible issues floated by them. Companies are also arranging loan facilities for investment in their issues in cooperation with the banks.

The above measures are in the right direction. New measures to suit the evolving needs of the investment climate must be taken up immediately.
3.10. LIMITATIONS OF STOCK EXCHANGES:

Old-fashioned and out-moded practices and accounting systems still continue in the day to day operations of the stock exchanges. As a result, delays and malpractices continue to disrupt the functioning.

Liquidity for shares is restricted to a select few scrips. Over 60 percent of the total turnover in the secondary market is accounted for by hardly 1 per cent of the equities listed. 50 per cent of the securities virtually remain untraded in any year and many of the untraded shares remain so for years together. This lack of liquidity affects the investors very much.

A great majority of the transactions in cleared securities are purely for speculative purposes. Eventhough forward trading was banned in 1969, a similar system prevails in the market. Brokers do not report the correct volume of trading to avoid 'margins'.

Insider trading is common. It is well known that big business houses in Bombay and Calcutta daily trade in the securities of the companies under their control. The present laws are loose and vague.

Financial institutions dominate the market and have the necessary clout to beat the market. Bhatt notes: "Not the fundamentals, nor the market forces of demand and supply, but the timing, the extent of buying and selling of scrips/bonds, choice of scrips/bonds preferred by these Financial Institutions that determine the contours and complexion of the stock markets, especially the Bombay Stock Exchange. The over-involvement of financial institutions distort the equilibrium of the market".
The governing boards of the stock exchanges are dominated by the brokers. Nominee directors from the public, Government and financial institutions are in a minority. Brokers influence the decisions of the board.

Manipulation of prices goes on. The monitoring mechanism is weak. And there is dearth of variety in financial instruments to suit the needs of different types of investors.

Equity shareholding has not spread any significant extent to the semi-urban and rural areas of India as a whole. Two thirds of the country’s individual equity shareholders are accounted for by five cities, viz., Bombay, Calcutta, Delhi, Ahmedabad and Madras.

Apart from the above limitations, stock exchanges of developing economies like India suffer from some other limitations also. They include: lack of financial development in capital markets, lack of timely information to the shareholders and investment preference given to physical assets than the financial assets.

3.11 CONCLUSION

For speedy development of stock exchanges, it is necessary to take suitable steps to remove the limitations immediately. Rao opines that “...the structure and the functioning of stock markets call for thorough overhauling.” The loopholes must be plugged, regulations must be made stringent, administrative machinery must be tightened, the governing boards must be broadened, new instruments to attract investors must be introduced, upcountry investors must be educated and above all a confidence in the functioning of stock exchanges must be created in the minds of the people.
Notes and References


2. Non-cleared shares are those whose transactions must be settled within 14 days. Settlement in Cleared securities can be carried over to the next settlement period by paying charges.

3. Odd-lot shares are those which are not in 'marketable lots'. Usually they command a lesser price.


5. Option is the right to buy or sell a certain quantity of security at a certain price within a certain time.

6. Transfer of securities without specifying the transferee.


8. ibid., p.9.

9. The place through which the transactions of the brokers among themselves are settled at the end of a period. The process is similar to the clearing house run by commercial banks.

10. The price fixed temporarily for each share at the end of a settlement period to adjust the amount due to or from amongst the members. This price is based on the previous market prices of the concerned shares.

11. Carryover or 'budla' is the facility of postponing transaction till the next settlement day. Postponement is effected by payment of 'budla' charge.


15. ibid., p.22.

16. Rao. op.cit., p.11


19. Margins are imposed to restrict overtrading and compel members to maintain deposits proportionate to the risk attached to their volume of business.

20. Trading in securities by misusing the special access to information, which is not available to all, by persons in the management.


22. ibid., p.15


24. ibid., p.12.
