CHAPTER - V

TRENDS IN
INDIAN CAPITAL MARKET
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5.1. INTRODUCTION

Capital Market is the barometer of the economy. This statement truly brings out the importance of the capital market in the macro economic affairs of any country. There is an age old saying that, "the capital market discounts the future". The state of the capital market does not reflect the pastor present but is a reflection of future of the economy of any country. In the long run it is a true measure of the health of any economy. In the recent years worldwide the countries are moving towards capitalism. In fact the core socialist and communist countries like Russia and China have embraced capitalism. In any capitalist economy, capital markets play a pivotal role in the economy. On breaking up of the shackles of protectionism and with the liberalisation and globalisation of economics, the world is becoming a global Village and the role of capital markets is assuming greater importance. However larger the role of capital markets, greater the responsibility on the regulators, participants, investors for the smooth functioning of the capital markets. The story in India is no different.

The active journey of capital markets in India started more than a century go in the year 1875 on the formation of the "Native Share and Stock broker Association" which transformed into a large, vibrant and modern stock exchange which is today popularly known as The Stock Exchange, Mumbai (BSE). In fact, India should take pride in the fact that it was the first country in Asia where a stock exchange was established. The long and treacherous journey of the capital market during the two world wars and great depression of the 1930s have not shaken the foundation of the capital markets in India.
The current state of the Indian capital market can be summarized as under:

5.2. INVESTOR POPULATION

The Society for Capital Market Research and Development carries out periodical surveys of household investors to estimate the number of investors. Their first survey carried out in 1990 placed the total number of share owners at 90-100 lakh. Their second survey estimated the number of share owners at around 140-150 lakh as of mid-1993, their latest survey estimates the number of shareowners at around 2 crore at 1997 end, after which it remained stagnant upto the end of 1990s. The bulk of increase in number of investors took place during 1991-94 and tapered off thereafter. 49% of the share owners at the end of 2000 had, for the First time, entered the market before the end of 1990, 44% entered during 1991-94, 6.3% during 1995-96 and 0.8% since 1997. The survey attributes such tapering off to persistent depression in the share market and investors' bad experience with many unscrupulous company promoters and managements.

According to the SEBI-NCAER survey of Indian investors conducted in early 1999, an estimated 12.8 million, or 7.6% of all Indian households representing 19 million individuals had directly invested in equity shares and or debentures as at the end of financial year 1998-99. The investor households increased at a compound growth rate of 22% between 1985-86 and 1998-99. About 35% of investor households became investors in equity shares prior to 1991, while 47% of the investors entered the market between 1991 and 1995 and 17% after 1995. More than 156 million or 92% of all Indian households were non-investor households who did not have any investments in equity/debentures. Low per capita income, apprehension of loss of capital and economic insecurity, which are all inter-related factors, significantly influenced the investment attitude of the households. The lack of awareness about securities market and absence of a dependable infrastructure and
distribution network coupled with aversion to risk inhibited non-investor households from investing in the securities market.

An estimated 15 million (nearly 9%) of all households representing at least 23 million unit holders had invested in units of mutual funds. Total investible resources of mutual funds account for about 23% of market capitalisation compared to more than 50% in developed countries. The mutual funds have not yet become an attractive investment avenue for the low and middle-income groups.

5.3. PRIMARY MARKET

The state of Primary Market of late has not been very encouraging. The amount mobilised through the Primary Market, is predominantly by financial Institutions and banks opposed to Industry. The trend and Resource Mobilization has been explained by the way of table 5.1.
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<td>16,366</td>
<td>23,537</td>
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<td>48,084</td>
<td>36,689</td>
<td>37,147</td>
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<td>60,192</td>
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<td>16,366</td>
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<td>36,193</td>
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<tr>
<td>Public Co</td>
<td>4,312</td>
<td>6,193</td>
<td>19,803</td>
<td>19,330</td>
<td>26,417</td>
<td>16,075</td>
<td>10,410</td>
<td>3,138</td>
<td>5,013</td>
<td>5,153</td>
<td>4,890</td>
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<td>PSU Bonds</td>
<td>5,663</td>
<td>5,710</td>
<td>1,062</td>
<td>5,586</td>
<td>3,070</td>
<td>2,292</td>
<td>3,394</td>
<td>2,982</td>
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<td>-</td>
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<td>Govt. Companies</td>
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<td>819</td>
<td>888</td>
<td>1,000</td>
<td>650</td>
<td>43</td>
<td></td>
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<td>Banks &amp; FLS</td>
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<td>356</td>
<td>3,843</td>
<td>425</td>
<td>3,465</td>
<td>4,352</td>
<td>1,476</td>
<td>4,352</td>
<td>2,551</td>
<td>1,472</td>
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<td>Private Placement</td>
<td>4,244</td>
<td>4,463</td>
<td>1,635</td>
<td>7,466</td>
<td>11,174</td>
<td>13,361</td>
<td>15,066</td>
<td>30,099</td>
<td>49,679</td>
<td>61,259</td>
<td>67,836</td>
<td>64,950</td>
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<td>Euro Issues</td>
<td></td>
<td></td>
<td>702</td>
<td>7,898</td>
<td>6,743</td>
<td>1,297</td>
<td>5,594</td>
<td>4,009</td>
<td>1,148</td>
<td>3,487</td>
<td>4,197</td>
<td>2,342</td>
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<td>Government Securities</td>
<td>11,558</td>
<td>12,284</td>
<td>17,690</td>
<td>54,533</td>
<td>43,231</td>
<td>46,783</td>
<td>42,688</td>
<td>67,386</td>
<td>106,067</td>
<td>113,336</td>
<td>128,483</td>
<td>152,508</td>
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<td>Central Government</td>
<td>8,989</td>
<td>8,919</td>
<td>13,885</td>
<td>50,388</td>
<td>38,108</td>
<td>40,509</td>
<td>36,152</td>
<td>59,637</td>
<td>93,953</td>
<td>99,630</td>
<td>115,183</td>
<td>133,801</td>
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<tr>
<td>State Government</td>
<td>2,569</td>
<td>3,364</td>
<td>3,805</td>
<td>4,145</td>
<td>5,123</td>
<td>6,274</td>
<td>6,536</td>
<td>7,749</td>
<td>12,114</td>
<td>13,706</td>
<td>13,300</td>
<td>18,707</td>
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<tr>
<td>Total</td>
<td>25,777</td>
<td>28,650</td>
<td>41,227</td>
<td>99,031</td>
<td>91,315</td>
<td>83,472</td>
<td>79,835</td>
<td>109,511</td>
<td>166,259</td>
<td>185,786</td>
<td>206,879</td>
<td>226,911</td>
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<tr>
<td>Mutual Funds</td>
<td>7,508</td>
<td>11,253</td>
<td>13,021</td>
<td>11,243</td>
<td>11,275</td>
<td>-5,883</td>
<td>-2,037</td>
<td>4,064</td>
<td>3,611</td>
<td>19,953</td>
<td>11,135</td>
<td>8,024</td>
</tr>
</tbody>
</table>

Note: Turnover figures for the respective years - Information not available. / There was no trading.

5.4. CORPORATE SECURITIES – ANALYSIS OF PRIMARY MARKET

Average annual capital mobilisation from the primary market, which used to be about Rs.70 crore in the 1960s and about Rs.90 crore in the 1970s, increased manifold during the 1980s, with the amount raised in 1990-91 being Rs. 4,312 crore. It received a further boost during the 1990s with the capital raised by non-government public companies rising sharply to Rs. 26,417 crore in 1994-95. The market, however, appears to have dried up since 1995-96 due to interplay of demand and supply side forces. In real terms, the amount raised by non-government public companies during 2001-02 is about 60% of the amount raised a decade back in 1990-91.

Many investors who were lured into the market during 1992-94 seem to be adopting a very cautious approach because of their frustration with some of the issuers and intermediaries associated with the securities market. They have not completely withdrawn from the market, but are looking for quality issues the availability of which has defined due to stricter eligibility criteria for public issues imposed by SEBI and the general slowdown in the economic activity. Simultaneously, issuers have shifted focus to other avenues for raising resources like private placement where compliance is much less. Available data (Table 5.1), although scanty, indicate that private placement has become a preferred means of raising resources by the corporate sector. It accounted for about 89% of total resources mobilised through domestic issues by the corporate sector during 2001-02. Rapid dismantling of shackles on institutional investments and deregulation of the economy are driving growth of this segment. There are several inherent advantages of relying on private placement route for raising resources. While it is cost and time effective method of raising funds and can be structured to meet the needs of the entrepreneurs, it does not require detailed compliance with formalities as required in public or rights issues. It is believed in some circles that private
placement has crowded out public issues. Indian market is getting integrated with the global market though in a limited way through euro issues. Since 1992, when they were permitted access, Indian companies have raised about Rs. 37,000 crore through ADRs/GDRs. By the end of March 2002, 490 FIs were registered with SEBI. They had net cumulative investments over of US $ 15 billion by the end of March 2002.

The market is getting institutionalised as people prefer mutual funds as their investment vehicle, thanks to evolution of a regulatory framework for mutual funds, tax concessions offered by government and preference of investors for passive investing. The net collections by mutual funds picked up during 1990s and increased to Rs.19,953 crore during 1999-2000 (Table 5.1). This however, declined to Rs.8,024. crore during 2001-02. Starting with an asset base of Rs.25 Crore in 1964, the total assets under management at the end of March 2002 was Rs.100,594 crore. The number of households owning units of MFs exceeds the number of households owning equity and debentures.

5.5. GOVERNMENT SECURITIES

The primary issues of the Central Government have increased many-fold during the decade of 1990s from Rs.8,989 crore in 1990-91 to Rs.133,801 crore in 2001-02 (Table 5.1.). The issues by state government increased by about five times from Rs.2,569 crore to Rs.18,707 crore during the same period.

PRIMARY MARKET - REFORMS

→ Introduction of regulations for primary and secondary market intermediaries, bringing them within the regulatory framework.
→ Introduction of pro rata allotment of shares. Reservation of minimum 50% of net offer to small investors who have applied for 1,000 or lesser shares/securities.

→ Authorising SEBI's representative to supervise the allotment process to ensure that no malpractice takes place in over-subscribed of issue procedures.

→ Allowing Mutual Funds and Foreign Institutional Investors to apply for firm allotment in public issues.

→ Minimum application size and the minimum number of share to be applied for have been reduced from Rs.5,000 to Rs.2,000 and Rs.500 to Rs.200 respectively for the benefit of small investors.

→ The due diligence certificate by lead managers regarding disclosures made in the offer document, made a part of the offer document for better accountability.


→ Listing agreements of stock exchanged amended to require listed companies to furnish annual statement to the stock exchanges showing variations between financial projections and projected utilisation of funds in the offer documents and at actual, to enable shareholders to make comparisons between performance and promises.

→ Abolition of Capital Issues (Control) Act and according permission for free fixation of pricing.

→ Reconstitution of governing boards of stock exchanges, introduction of capital adequacy norms for brokers and issue of rules for making the client/broker relationship more transparent, in particular segregating client and broker accounts.
Underwriting made optional with a view to reduce the cost of issue, provided if at least 90% of the amount offered to the public is not received, the entire amount collected shall be refunded.

SEBI dispensed with the vetting or rights issues which are not accompanied by public issues three months prior or subsequent to the rights issue.

To vet the draft prospectus within 21 days and mandatory period between the date of approval of the prospectus by the ROC and the opening of the issue to be reduced to 14 days.

Corporate advertisements, between the date of issue of acknowledgement card and the date of closure of the issue have been allowed, subject to specific conditions which include the disclosure of risk factors.

In respect of debt issues, 100% book-building permitted and the requirement of minimum 90% subscription waived in respect of exclusive debt issues provided adequate disclosure about the alternate source of finance have been made.

The book-building has been made optional for all body corporate irrespective of the size of the issue. In case of under-subscription spill over from the placement portion to the net public offer portion and vice-versa have been allowed.

The requirement for the promoters to bring their entire contribution before the opening of an issue in case the promoters contribution in the company exceeds Rs.100 crores relaxed and the promoters allowed henceforth bring in 50% of their contribution before opening of issue and balance 50% in advance pro rate before calls made on the public.
The validity period of letters issued by SEBI giving observation filed with SEBI was decided to be extended to 365 days from the date of observation letter.

Regulations governing various market intermediates, viz, portfolio managers, stock brokers and sub-brokers, merchant bankers, registrars to issue and share transfer agents, underwriters, debenture trustees, bankers to issue, depositaries, participants and custodians of securities, have been notified. These intermediaries require registration from SEBI subject to certain authorisation criteria and capital adequacy norms.

5.6. SECONDARY MARKET

Analysis of Secondary Market-Corporate Securities

Selected indicators in the secondary market are presented in Table 5.2. The number of stock exchanges increased from 11 in 1990 to 23 now. All the exchanges are fully computerised and offer 100% on-line trading. 9644 companies were available for trading on stock exchanges at the end of March 2002. The trading platform of the stock exchanges was accessible to 9,687 members from over 400 cities on the same date.
<table>
<thead>
<tr>
<th>At the End of Financial year</th>
<th>No. of Brokers</th>
<th>No. of Listed Companies</th>
<th>S&amp;P CNX Nifty</th>
<th>Market Cap</th>
<th>Market Cap Ratio (%)</th>
<th>Turnover</th>
<th>Turnover Ratio (%)</th>
<th>SGL Trun Over</th>
<th>Derivatives Turnover</th>
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</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>-</td>
<td>6,229</td>
<td>366.45</td>
<td>110,279</td>
<td>20.6</td>
<td>-</td>
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<tr>
<td>1991-92</td>
<td>-</td>
<td>6,480</td>
<td>1261.65</td>
<td>354,106</td>
<td>5704</td>
<td>-</td>
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<td>1992-93</td>
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<td>6,925</td>
<td>660.51</td>
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<td>32.4</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>1993-94</td>
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<td>7,811</td>
<td>1177.11</td>
<td>400,077</td>
<td>45.6</td>
<td>203,703</td>
<td>50.9</td>
<td>-</td>
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<td>1994-95</td>
<td>6,711</td>
<td>9,077</td>
<td>990.24</td>
<td>473,349</td>
<td>45.6</td>
<td>162,905</td>
<td>34.4</td>
<td>50,569</td>
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<td>1995-96</td>
<td>8,476</td>
<td>9,100</td>
<td>985.30</td>
<td>572,257</td>
<td>47.0</td>
<td>227,368</td>
<td>39.7</td>
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<td>1996-97</td>
<td>8,867</td>
<td>9,890</td>
<td>968.85</td>
<td>488,332</td>
<td>34.6</td>
<td>646,116</td>
<td>132.3</td>
<td>122,941</td>
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<td>1997-98</td>
<td>9,005</td>
<td>9,833</td>
<td>1116.65</td>
<td>589,816</td>
<td>37.7</td>
<td>908,681</td>
<td>154.1</td>
<td>185,708</td>
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<td>1998-99</td>
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<td>9,877</td>
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<td>574,064</td>
<td>34.1</td>
<td>1,023,382</td>
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<td>1999-00</td>
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<td>9,871</td>
<td>1528.45</td>
<td>1,192,630</td>
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<td>173.3</td>
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<td>2001-02</td>
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<td>9,644</td>
<td>1129.55</td>
<td>759,248</td>
<td>36.4</td>
<td>895,826</td>
<td>119.6</td>
<td>1,555,653</td>
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Note: Turnover figures for the respective year; - Information Not Available / There was no trading.

The market capitalisation grew ten fold between 1990-91 and 1999-2000. All India market capitalisation is estimated at -Rs. 749,248 crore at the end of March 2002. The market capitalisation ratio, which indicates the size of the market, increased sharply to 85% by March 2000. It, however, declined to 36% by end March 2002. Traditionally, manufacturing companies and financial services sector accounted for a major share in market capitalisation. However, in the recent past, the importance of these traditional sectors has declined and new sectors like, information technology, pharmaceuticals and fast moving consumer goods have picked up.

The trading volumes on exchanges have been witnessing phenomenal growth during the 1990s. The average daily turnover grew from about Rs. 150 crore in 1990 to Rs. 12,000 crore in 2000, peaking at over Rs. 20,000 crore. One-sided turnover on all stock exchanges exceeded Rs. 10,00,000 crore during 1998-99, Rs. 20,00,000 crore during 1999-2000 and approached Rs. 30,00,000 crore during 2000-01. However, it defined substantially to Rs. 895,826 crore in 2001-02. The turnover ratio, which reflects the volume of trading in relation to the size of the market, has been increasing by leaps and bounds after the advent of screen based trading system by the NSE. The turnover ratio for the year 2000-01 increased to 375 but fell substantially due to bad market conditions to 119 during 2001-02.

The relative importance of various stock exchanges in the market has undergone dramatic change during this decade. The increase in turnover took place mostly at the big exchanges and it was partly at the cost of small exchanges that failed to keep pace with the changes. NSE is the market leader with over 80% of total turnover (volumes on all segments) in 2001-02. Top 6 stock exchanges together accounted for 99.88% of turnover, while about a dozen exchanges
reported nil turnover during the year. The big exchanges now report higher turnover from its trading terminals in the home turf of most of the corresponding regional exchanges.

The sectoral distribution of turnover has undergone significant change over last few years. The share of manufacturing companies in turnover of top '50' companies, which was nearly 80% in 1995-96, declined sharply to about 6% in 2001-02. During the same period the share of IT companies in turnover increased sharply from nil in 1995-96 to 67% in 2001-02. Trades concentrate on a few securities/members, though decreasing concentration of trades is observed in the recent years. Top '5' and 100' securities accounted for 44% and 96% of turnover respectively during 2001-02. During the same period, top '5' and 100' members accounted for 7% and 53% of turnover respectively.

Many securities listed on stock exchanges are not traded and trading in many other securities is negligible. On an average about 25% companies at BSE were traded every month during 2001-02. Only 23.15% of companies traded on BSE were traded for more than 100 days during 2001-02. Trading took place for less than 100 days in case of 76.85% of companies traded at BSE during the year, and for less than 10 days in case of 24.76% of companies traded. On an average 93% of companies available for trading at NSE were traded every month during 2001-02. Nearly 78% of companies traded on NSE were traded for more than 100 days during 2001-02. There was no trade in several companies listed on a number of regional stock exchanges. This indicates that trading is concentrated among only a limited number of stocks and is very thin in a large number of stocks.

In the very first year of liberalisation, i.e. 1991-92, the S&P CNX NIFTY, the most widely used indicator of the market, recorded a growth of 267%,
followed by sharp decline of 47% in the next year as certain irregularities in securities transactions were noticed. Since then, the market experienced a roller coaster ride till 1999-2000 when the Nifty firmed up by 42% due to perception about the strength of the government and its commitment towards second generation reforms, improved macroeconomic parameters and better corporate results. The trend got reversed during 2000-01, which witnessed large sell-offs in new economy stocks in global markets, deceleration in the growth of the domestic economy, market turbulence following allegations of large scale irregularities in securities transactions, and revelation of large scale corruption in the procurement of defence equipments. The trend precipitated further during 2001-02 with introduction of rolling settlement and withdrawal of deferral products in July 2002, suspension of repurchase facility under UTI's US-64 scheme, terrorist attack on World Trade Centre in September 2002.

5.7 GOVERNMENT SECURITIES

The aggregate turnover in central and state government dated securities, including treasury bills, through SGL transactions increased 31 times between 1994-95 and 2001-02. During 2001-02 it reached a level of Rs.1,573, 893 crore, higher than combined trading volumes in equity segments of all the exchanges in the country, reflecting deepening of the market. The share of outright transactions in government securities increased form 23.2% in 1995-96 to 77% in 2001-02. The share of repo transactions declined correspondingly from 76.8% in 1995-96 to 23% in 2001-02. The share of dated securities in turnover of government securities increased from 69% in 1996-97 to 94% in 2001-02. The T-bills accounted for remaining SGL turnover.
5.8 SECONDARY MARKET-REFORMS

Stock exchanges are allowed to introduce carry forward system only with the prior permission of SEBI, subject to effective monitoring and surveillance system and infrastructure.

(1) Members doing financing of carry forward transactions will be subject to a capital of Rs.10crores.

(2) Introduction of regulations governing substantial acquisition of shares and takeover laying down conditions under which disclosures and mandatory public offers are to be made to shareholders.

(3) Framing of regulations for banning insider trading and prohibition of fraudulent and unfair trade practices relating to securities market.

(4) Compulsory audit of broker books and filing of audit reports with SEBI has been made mandatory under the SEBI (stock Brokers and Sub-brokers) Rules and Regulations, 1992.

(5) Enactment of Depositories Act to provide a legal framework for the establishment of depositories to record ownership details in book entry form.

(6) Issue of Guidelines for the public representatives and the Government nominees on the Governing Boards of the Stock Exchanges requiring them to ensure that governance of the stock exchange activities is impartial.

(7) Prescription of uniform norms for good and bad deliveries which are now followed by all market participants. This has reduced the number of disputes and ensured smooth and speedy resolution of bad deliveries.
(8) To prevent certain irregularities and to improve the percentage of deliveries to the total turnover, stock exchanges were required to introduce a system of compulsory delivery of the transactions covered under negotiated deals with effect from 1.6.1997.

(9) All stock exchanges have been advised to create a database of all broker-members which would include particulars of operational history such as their assets base, capital and net worth, volumes, defaults and investor complaints. This was intended to facilitate an evaluation of their performance and compliance with applicable laws.

(10) Issue of fresh guidelines for advertising by mutual funds and removal of requirements of pre-vetting of advertisements.

(11) Formation of clearing house or clearing corporation by stock exchanges at the instance of SEBI

(12) Introduction of stock lending scheme, stock lending has been approved in which short sellers can borrow securities through an intermediary before making such sales. The approved intermediary should have minimum networth of Rs.50crores.

(13) All stock exchanges have been required to ensure that a system is put in place whereby each transaction is assigned a unique order code number which is intimated by the broker to his client. Once the order is executed, this number is to be printed on the contract note.
(14) SEBI's activities in the area of market development also focussed on the introduction of securities lending and on initiating the process of introduction of derivatives trading in India.

(15) Setting up of a core group for inter-exchange market surveillance for coordinating action in case of abnormal volatility,

(16) All stock exchanges to institute the buy-in or auction procedure being followed by the National Stock Exchange.

(17) Mutual Funds permitted to underwrite public issues and guidelines for investment in money market instruments relaxed. The recommendation of the expert committee on NAV, Mutual Funds, 2000 Report have been accepted. Revised Mutual Funds Regulations 1996 have been notified to bring about greater transparency and uniformity\(^1\).

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The market participants of Indian capital market as on 31\textsuperscript{st} March 2002 has been furnished below.

**TABLE 5.3**
MARKET PARTICIPANTS

<table>
<thead>
<tr>
<th>Market Participants</th>
<th>Number as on 31st March, 2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities Appellate Tribunal</td>
<td>1</td>
</tr>
<tr>
<td>Regulators</td>
<td>4</td>
</tr>
<tr>
<td>Depositories</td>
<td>2</td>
</tr>
<tr>
<td>Stock Exchanges</td>
<td>-</td>
</tr>
<tr>
<td>With Equities Trading</td>
<td>23</td>
</tr>
<tr>
<td>With Dept Market Segment</td>
<td>1</td>
</tr>
<tr>
<td>With Derivative Trading</td>
<td>2</td>
</tr>
<tr>
<td>Listed Securities</td>
<td>9922</td>
</tr>
<tr>
<td>Brokers</td>
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</tr>
<tr>
<td>Foreign Brokers</td>
<td>38</td>
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<tr>
<td>Corporate Brokers</td>
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<tr>
<td>Sub-Brokers</td>
<td>9957</td>
</tr>
<tr>
<td>FIIs</td>
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<tr>
<td>Portfolio Managers</td>
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<tr>
<td>Custodians</td>
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<tr>
<td>Share Transfer Agents</td>
<td>186</td>
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<tr>
<td>Primary Dealers</td>
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<tr>
<td>Merchant bankers</td>
<td>233</td>
</tr>
<tr>
<td>Bankers to an Issue</td>
<td>69</td>
</tr>
<tr>
<td>Debenture Trustees</td>
<td>37</td>
</tr>
<tr>
<td>Underwriters</td>
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</tr>
<tr>
<td>Venture Capital Funds</td>
<td>35</td>
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<tr>
<td>Foreign Venture Capital Investors</td>
<td>1</td>
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<tr>
<td>Mutual Funds</td>
<td>39</td>
</tr>
<tr>
<td>Collective Investment Schemes</td>
<td>4</td>
</tr>
</tbody>
</table>

Source: Indian Securities Market - A Review (NSE)

* DCA, DEA, RBI * SEBI

India (NSE), which was established in the year 1994 made rapid strides and has strength of 850 members in many cities spread across the length breadth of the country. The NSE since inception was an electronic exchange.

5.9. DERIVATIVES MARKET

The Indian capital markets did not have derivative products in which investors could trade in. The SEBI had constituted a committee on derivatives under the Chairmanship of Dr. LC Gupta to develop appropriate regulatory framework for derivatives trading in India. Pursuant to the recommendations of the committee, derivatives instruments were gradually introduced into, the capital markets. The derivatives instruments constitute a separate segment of the exchange. Presently, BSE & NSE are the two stock exchanges which are permitted to start derivative market segments. The derivatives instruments have been well received by the various market participants and the turnovers have increased manifold within a short span of time after their introduction.

5.10. DEBT MARKET

The debt market in India has not developed as much as the equity market. There is no trading floor where brokers bid and offer debt securities. There is no standardised market lot for purchase and sale of such securities. There is no settlement of transactions by an Exchange. The brokers/traders in the debt market negotiate the deal privately and the deal is struck. This deal is completed by the two parties, to the deal. Hence the debt market in India is still not as transparent as the equity market. The predominant security in the debt market is government security. The debt instrument of corporates, financial institutions and banks constitute a tiny proportion of the entire debt market.
5.11. FOREIGN INSTITUTIONAL INVESTORS (FII)

The Foreign Institutional Investors (FII) were granted permission to participate in the capital market since 1992. The FII s have shown tremendous interest in Indian capital market and pumped in large amounts of money in acquiring stocks from the capital market.

5.12 MUTUAL FUNDS

One of the important developments in the capital markets is the participation of mutual funds. The concept of the mutual fund started way back in 1963 by the creation of Unit Trust of India by an Act of the Parliament. The Unit Trust of India floated several schemes and grew in size. The first scheme launched by UTI was US 64 which is till date the largest scheme ever launched by any other mutual fund. The Public Sector Banks and Financial Institutions floated mutual funds from the year 1987. Later on SEBI permitted private players in the mutual fund by bringing in proper regulations.

5.13. FUTURE DEVELOPMENTS

Disclosure Norms for Private Placements

In the recent past few years, there is a rapid growth of private placement issues. Reasons for such rapid growth may be attributed to facts like, lower disclosure requirements, lower issue cost and faster source of financing. The private placements do not require detailed compliance with preparation of offer documents, which are required in case of a public issue. The argument that in private placement only big players like banks, institutions, mutual funds participate and therefore there is no need for stringent disclosure requirement is not valid since lack of information may result in bad investment -even for these

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players. Further, there were some issues of equity, which were placed privately where even the public participated. For better regulation of the private placements, it is advisable for SEBI Department of Company Affairs (DCA) to introduce minimum information requirement for floating private placements.

5.14. BOOK BUILDING PROCESS

Book building is an additional option available to companies wishing to raise funds either debt or equity. The equity raised is divided into two-parts, one raised through private placement and the other part is public offer.

The book building process is initiated by the book running lead manager after filling of the preliminary prospectus with SEBI by inviting various prospective syndicate members to join the syndicate of procurers. The invitees after ascertaining the demand may enter into a procurement agreement on best efforts basis with the book running lead manager.

The placement portion opens for subscription immediately after filling of prospectus with ROC and the syndicate members can then commence collecting subscriptions for the same.

The shares will be allocated on a firm basis up to the amount committed in the procurement agreement to them by the book running lead manager in consultation with the issuing company.

The main objective of the book building is to determine the highest market price for shares and demand level from high quality investors in order to adjust pricing and allocation decision.
5.15. e-IPO

Recently, SEBI has come up with guidelines for e-IPO (i.e. online initial public offer). The concept of e-IPO has not picked up, since the primary market for initial public offer itself was dull. Under this concept, the applications for securities are made through the terminals allotted by the exchange to its members. These members of the exchange act as a collection centre. They process the applications of their clients through their allotted terminals. All the applications are then received by the exchange and are sent to the Registrar for further processing. The applicant will issue the cheque in favour of the broker who shall then deposit the said amount to the exchange in its pay in obligation. The whole process will reduce the time for processing the application and allotment. It is expected that this route of making IPO would catch up because of its obvious advantages.

5.16. INTERNET TRADING

Internet has become an important part of each person's life. The usage is growing day by day, Internet is a good medium, which can be used as an efficient tool for trading in shares. Internet is a medium through which communication takes place between two computers. A person from anywhere in globe can access another computer on the Internet. The brokers would set up software for trading in shares on their website. Their clients would access the website of the broker and would place orders for buying and selling of shares. These orders would be executed by the broker electronically either through counter orders from another client or on the stock exchange with another broker. With the payment gateways built by banks, it would be very easy for transfer of funds upon execution of transaction. It is believed that internet would change completely the way in which transactions on the exchange takes place. The volumes will increase manifold in
view of the ease with which the transactions could be put through especially in
case of small investors. The activity of transacting on a stock exchange would not
only be restricted to exchange floor, exchange terminals from the offices or
from homes but even while one is mobile, say in a car or train or for that matter in
a aircraft. This would be made possible with WAP-Wireless Application Protocol.
WAP is a mode of communication between the mobile phone and another mobile
phone or a computer. With the wireless world a reality, the capital market will see
a sea change in the way in which the transactions are put through.

5.17. MARGIN TRADING

Margin Trading is purchasing securities by borrowing a portion of the
transaction value and using the securities in the portfolio as collateral. It increases
the purchasing power of the investors. This would lead to leveraging and
expansion of portfolio.

5.18. ROLLING SETTLEMENT

The rolling settlement in the capital market has seen settlement cycles
coming down from a fortnight to five to three days at present. The capital markets
are very rapidly moving towards one-day settlement of transactions, which is
popularly known as T+1 ('T' denotes "trade day) For this to happen, it is essential
that banking reforms also are implemented at the earliest. Today, it takes one to
three days for a cheque to get cleared through the clearing house. In case of
outstation cheques, the time is still longer. This period should be brought down in
order to successfully implement the shorter rolling settlement. The advantage of
the shorter settlement is early settlement of transactions, which benefits the
brokers as well as the investors.
5.19. RISK MANAGEMENT SYSTEMS AT THE EXCHANGES

The risk management systems at the exchanges has improved substantially in the recent past because of positive steps taken by the exchanges in terms of prescribing capital adequacy norms for members, margins on line surveillance and inspection of broker's books. The margin systems have become more sophisticated to consider the factors of volatility, volumes and other factors. The margins are required to be compulsorily collected from the clients by the brokers. A quarterly certificate has been prescribed for compliance of the margin system. With the infrastructure of risk management enhanced, the stock exchanges as well as the investors would be better protected towards risks of various scams which had recently shaken the market.

5.20. REGULATORS

There are four primary regulators who are regulating the capital markets. There is no clear cut demarcation of areas where they are required to regulate. In the past, this has created problems and there are no effective steps taken to resolve this issue. The classic case of menace of vanishing companies was an eye opener where regulators were ineffective because of the lack of clarity of role of regulators. It is of paramount importance that the role of each regulator is well defined and there should be no confusion regarding the power to regulate.

The menace of insider trading uproots the very roots of capital market. The confidence of investors is shaken when management fraudulently cheat the public by indulging in insider trading. Effective steps must be taken to boost public confidence in the capital markets. In the United States of America, there is a rule which makes it mandatory for any executive of a company in who deals in the shares of the company in which he is employed, to file a declaration with the
Securities Exchange Commission of USA (SEC) giving complete details of the transaction. This information is thereafter linked to the website of stock exchange where the company's shares are listed and in turn the exchange makes it available to public. This brings transparency in the system and inspires confidence in the public. Such developments may be expected in India too.

SEBI Act is being amended in the near future enhancing the powers of the SEBI and increasing the maximum limit of penalty which it can levy for defaults.

5.21. FINANCIAL REPORTING FRAMEWORK AND CORPORATE GOVERNANCE

The SEBI, DCA and the Institute of Chartered Accountants of India (ICAI) are working on strengthening the financial reporting framework in India. Many initiatives taken in the recent past would go a long way in inspiring confidence in the investing public. The Accounting Standards recently formulated by the ICAI some of which have got implemented in the year ended 31st March 2002 and others which would get implemented in the subsequent periods would usher a new trend in the financial reporting framework in India. The ICAI is also actively putting in place various auditing standards which would raise the standards of auditing. The system of peer review recently introduced by the ICAI would improve the over-all quality of audits. The ICAI is also formulating several guidance notes on accounting and auditing matters.

The SEBI has put in place the code of corporate governance by amending the listing agreement. Though the code requires corporates to follow it in letter and spirit, experience has shown that it is often followed in letter than in spirit. There are few exceptions one of which is Infosys Technologies Limited. Infosys has broad based its board of directors by taking several good professionals on the board. Infosys, much before the introduction of code of corporate governance was
following it in its true spirit. Corporates would realise the importance of corporate governance and its advantages in terms of increasing its valuations,

5.22. NON-GOVERNMENT ORGANISATIONS (NGOs)

The corporate democracy in India has not matured and the managements often take advantage of this aspect in taking decisions which are favourable to the promoter shareholders against the interest of small shareholders. There is no effective voice of the small shareholders and often their interest are overlooked in favour of personal gains to the promoter shareholders. There is a need to have collective voice of the small shareholders which would be heard by the management. The Investors Grievance Forum (IGF) led by Mr. Kirit Somaiya, Member of Parliament and a Chartered Account has rendered yeoman service in the area of protecting the interests of the small shareholders. In fact their voice is heard not only by the management but also the regulators. They have also rendered service to small shareholders by conducting several investor's education programs. This movement of collective initiative of small shareholders would go a long way in strengthening the corporate democracy in India.

5.23. INVESTOR PROTECTION

Investors are the backbone of the securities market. Protection of their interest is essential for sustenance of their interest in securities and hence development of market.

The consumer for a provide an expeditious remedy to a consumer who has suffered loss an account of deficiency in goods/services purchased by him. A similar arrangement is called for redressal of investor grievances, given the rate of disposal of our judicial system. The investor forum as well as other authorities
should have power to dispose off the cases summarily and to award compensation to the investor. It is not enough if the culprit is punished. The culprit needs to be punished in an exemplary manner, while investor should have means to recover his loss caused by the culprit. The SEBI Act should empower SEBI not only to levy penalties, but also award compensation to investor.

The depositors are protected up to Rs. 1 lakh in the event of liquidation/bankruptcy of a bank. This protects innocent depositors and thereby contributes to the stability of the financial system. A similar mechanism may be developed to compensate an investor up to Rs. 5 lakh if he suffers a loss on account of the failure of the system or mischief by any market participant. An organisation called Securities Investor Protection Corporation operates in the USA to provide similar protection to investors.

The confidence of the investors can be maintained and enhanced by making provision for professional intermediation services. Industry/SROs/Regulators have made a modest beginning, but not adequate given the dimensions of the market. NCFM or any other suitable testing system should offer a certification for each type of intermediation service. The industry body should determine the syllabus and standards for such certification. The certified people should be required to update their skills and expertise by seeking certification at intervals of five years. The personnel having supervisory responsibilities with intermediaries and issuers, and also officers working with SROs and regulators need much broader exposure (equivalent to Principal of NASDR). There are institutes like the ICSI for grooming professionals for secretarial work or the ICAI for accounting work.

A similar institute, say National Institute of Securities Market (NISM), maybe statutorily set up with the responsibility to develop a distinct group of professionals for a career in the securities market. The personnel with supervisory
responsibilities must at least be associates of the NISM. SEBI regulations, which lay down various requirements for registration as an Intermediary, should specify certification as a mandatory requirement for operational level employees and associate membership of NISM for supervisory level employees. While this requirement should apply at the entry point for all new employees joining the intermediaries, regulation may allow a period of Five years for the existing employees to qualify the certification / associate examination. In addition, there should be an arrangement for grand fathering for a period of 3 years. During this period, persons at operational level with a certain minimum years experience and qualification may be exempted from the certification subject to completion of prescribed training and persons at supervisory level with specified qualification and experience may be allowed to become associates of NISM subject to passing a limited examination. NISM may maintain a database of its associates as well as certified professionals and enforce a code of conduct for them so as to enable prospective employers access the database to meet their personnel requirements. The certification may be developed and administered by industry associations under the regulatory oversight of SEBI, while NISM may be a statutory body modeled like ICSI.

An investor normally deals in securities through an intermediary, whose acts of omission and commission can cause loss to him. In order for the investor to choose the right intermediary through whom he may transact business, it may be useful to help him in taking informed decision by making details of intermediaries available to him. The details may include the form of organization, management, capital adequacy, liabilities, defaults and penal actions taken by the regulator and self-regulatory organizations against the intermediary in the past and other relevant information. If possible, the intermediaries may be rated and their ratings are disseminated.
5.24. UNITS VS. SECURITIES

Units of mutual funds (MFs) resemble securities. They represent the interest of the unit holder in the specific scheme just as securities represent the interest of the holder in the issuer. The unit holder has similar rights as a security holder has on the future performance of any underlying asset or group of assets. Special kinds of units (units of assured return schemes), which represent the rights of investors on a fixed income flow over the future years or a Fixed maturity value at the end of a specified period, are similar to debentures issued by companies. The units are issued, dematerialised, listed, traded on exchanges in a manner similar to any other security. These are transferred from one holder to another or sold back to the issuer, at pre-specified or market determined values, just like shares, debentures and other securities are. The holders of units and securities have the same need for safety, liquidity and return. Despite such close similarities between units and securities, they are not treated legally at par.

In terms of the definition in the SCRA, an instrument can be treated as 'securities', if

(a) it is enumerated in the definition, or
(b) it is
   (i) marketable,
   (ii) of like nature, and
   (iii) of or in any incorporated company or body corporate, or
(c) it is declared to be "securities" by the government.

The units of MFs are not explicitly listed in the definition. These have not been declared to be securities by the government. The only other way these can considered to be securities is that these satisfy all the ingredients as at (b) above.
These are clearly marketable as these are listed and traded on recognised stock exchanges. These are also of like nature as these represent an undivided share in the assets of scheme of a MF. However, a MF (except UTI) being a fund established in the form of a trust to raise monies through sale of units to public is not a body corporate and hence the units issued by it do not satisfy all the three ingredients and may not be covered within the ambit of 'securities'. However the units issued by UTI are securities, as UTI is a corporation under the UTI Act, 1963, although it is managed by a board of trustees. Thus, the units of non-UTI MFs are not considered securities explicitly under law, although investors in units of MFs need similar level of protection as applicable to securities.

In case of securities, the whole process of issue, allotment and transfer of securities and various aspects relating to company management and are provided in the Companies Act, 1956. In addition, SEBI's jurisdiction extends over corporates in the issuance of capital and transfer of securities. All these matters relating to units of MFs are provided in the SEBI regulations. Further, the trading of securities issued by corporates are governed by SCRA and regulatory framework developed thereunder, while trading of units are not subject to similar regulatory framework. In fact, trading of units is not subject to any regulatory framework. This presents a case of regulatory gap and this is one of the reasons why the secondary market for units has not developed appreciably. It is no argument that SEBI's jurisdiction over regulation of MFs under the SEBI Act, 1992 also extends over the trading of their units. If that were so, DCA would be having regulatory jurisdiction over trading of securities as well as the powers to regulate companies. The governance of the company and trading of securities issued by them are provided explicitly in two different statutes and administered by two separate regulators. Similarly the powers of SEBI under the SEBI Act, 1992 to regulate CIS is not enough to regulate trading of units of CIS.
The regulatory framework for trading units of collective investment schemes is from Securities Contract Regulation Act 1956. As per the SEBI Act 1992, mutual fund is a type of collective investment scheme. The issue of units certificates and trading of units are governed by the SEBI guidelines and regulations. Again, procedural aspects are ensured by SEBI and recognised stock exchanges. Normally, listing of securities is allowed in major stock exchanges. The same procedure is followed for mutual funds also. However, de-listing procedure is adopted very carefully on account of the following reasons:

1. The securities of the company have been listed for a minimum period of three years of any stock exchange.

2. A company, which has a convertible instrument outstanding, shall not be permitted to delist its equity shares, till the exercise of the conversion options.

3. A company may delist one or all its class of securities. However, if the equity shares of a company are delisted, the fixed income securities, may continue to remain listed on the stock exchange.

4. If the listing fees is not properly being paid within the scheduled date.

Therefore, the regulatory provisions listing and delisting procedure are the same for the securities and mutual fund units. SEBI has been entrusted with the responsibility of protecting the investors in securities and mutual funds also.

Since the jurisdiction of SEBI is limited to securities market and the units of MFs (except for units of UTI) are not explicitly recognised as securities in law, the actions of SEBI in protecting the interests of investors in units of MFs and developing a market for them is being challenged before the courts of law. In an
appeal before SAT, an appellant contended that he was not covered by the Rules as he was not dealing in securities, but in units of MFs which are not securities and hence the SEBI had no powers, authority or jurisdiction to conduct any enquiry or impose any penalty on him. While disagreeing with this, the SAT considered the units of MFs to be securities in view of the object and purpose underlying the SEBI Act. This judicial pronouncement needs to be codified in law. Since the units of MFs conform to the description "such other" instruments under the SCRA and can be declared as "securities" under the delegated powers, the government should declare units of MFs as 'securities' under the SCRA. Such declaration would help (i) the market regulator and stock exchanges to regulate trading of units more effectively with a view to protecting interest of investors therein, (ii) market for units to deepen, (iii) provide a level playing field to other MFs with UTI and (iv) remove confusion about the status of units of MFs. More importantly, this would remove the regulatory gap.

5.25. DEMUTUALISATION OF STOCK EXCHANGES

Historically the exchanges were formed as 'mutual' organisations. They are generally "not- for-profit" and tax exempted entities. The trading members who provide broking services, also own, control and manage such exchanges for their common benefit, but do not distribute the profits among themselves. In contrast, in a "demutual" exchange, three separate sets of people own the exchange, manage it and use its services. The exchanges frame and enforce rules, which may not always, further the public interest interests or tracing members; simultaneously. Theoretically public interest gets precedence in a demutualised exchange while private interest gets precedence in a mutual exchange in formulation and implementation of the rules. On realising the limitations of mutual structure and discovering the advantages of demutual structure, the stock
exchanges are increasingly organising themselves as commercial entities and undergoing a process of "demutualisation".

It is felt in some quarters that demutualisation would require substantive changes in law. The SCRA needs to be amended to provide that a stock exchange should be a company incorporated under the Companies Act and to accommodate two types of members (trading and shareholding). The Income Tax Act needs to be amended to provide that the accumulated reserves of the stock exchange as on the day of corporatisation are not taxed. The issue of ownership rights (shares) and trading rights in lieu of the membership card should not be regarded as transfer and not attract capital gains tax. The Indian Stamp Act and the Sales Tax laws may be amended to exempt from stamp duty and sales tax, the transfer of the assets from the mutual stock exchange and the issuance of shares by the new demutualised for-profit company.

The SCRA permits different structures for stock exchanges. That is why some exchanges are association of persons, some are company limited by shares, and some others are company limited by guarantee. Since the law permits any form for a stock exchange, it may not be possible to mandate a particular form for all exchanges. However, it may be noted that the SCRA is a skeleton legislation under which regulators and SROs have substantial delegated powers of legislation. Under the delegated powers of legislation, the regulators can specify and enforce a particular structure. As a condition of recognition/renewal of recognition, a stock exchange is required to comply with such conditions as are or may be prescribed or imposed under the provisions of the SCRA from time to time. Besides, the authorities have powers to direct stock exchanges to make rules or to amend rules. In the extreme case of non-compliance by 30th National Convention of Company Secretaries any stock exchange, the authorities can withdraw recognition. Further,
Demutualisation would result in two classes of members namely, trading members and shareholding members. Since 'member' under the SCRA means a member of the recognised stock exchange, it is apprehended in some circles that the SCRA may not accommodate different classes of members. It has been affirmed recently by the Supreme Court that there can be more than one class of members and they will fall within the definition of "members" under the SCRA. In view of these, no amendment in the SCRA is required.

Demutualisation involves transfer of assets and liabilities from the erstwhile mutual (non-corporate) exchange to the emerging demutual corporate) exchange. Since this transfer is a national transfer on conversion of the exchange from mutual to demutual form, and it is in public interest, the transfer of capital assets has been exempted from capital gains tax. The demutual exchanges would also inherit the accumulated serves and surplus which has grown because of so many concessions and tax benefits. Since it remains with the organization even after inversion and is not taken away by anybody, it would not be taxed. It would, however, require a restriction on distribution of this cumulated reserve and surplus inherited by demutual exchange, as these belonged to "while not-for-profit exchange. This reserve id surplus should be deployed by the exchange separately for common benefit of investors / change/market. All future profits of the organization should be subject to normal ration. In lieu of membership card, the existing brokers should be granted non-transferable trading rights against deposits and transferable ownership rights (equity shares). However, when they transfer ownership rights, they would be subject to capital gains tax and cost of these rights shall be the cost of requisition of the original membership. Thus, I the genuine tax exemptions required for 'mutualisation have already been provided the Income Tax Act.

Only change required in law is exempting all transactions associated with demutualisation stamp duty as this is being done in public.
5.26. CENTRAL LISTING AUTHORITY (CLA)

Under the current dispensation, while it is mandatory to list a security on a regional exchange, it can be listed on any number of exchanges. The issuer has option to list its securities on any one or more of the exchanges. The issue fails if the regional exchange refuses listing. The issue also fails if any of the exchanges, to which application for listing has been made, refuses to list the security. This arrangement, generates unhealthy competition. There is a competition among the issuers to list securities on as many exchanges as possible to attract investors from all over the country and waste resources to comply with the listing requirements of a number of exchanges simultaneously. Similarly there is a competition among the exchanges to attract as many issuers as possible at times leading to dilution of listing standards: particularly when listing constitutes a major source of income for many of them.

A corollary to the above is that there is a lot of avoidable waste. For all practical purposes, listing agreement is a one sided agreement, rather an undertaking, requiring the issuer to agree to all the conditions prescribed at the time of signing the agreement or to be prescribed subsequently. The agreement is also amended unilaterally. The issuer has absolutely no choice in the matter, as, none of the terms is negotiable. The issuer is deemed to have agreed to comply with anything that may be prescribed at any time in future. Even in the stock exchange does not have any freedom to vary any of the terms of the agreement Why should there be separate agreements for each security if it is the same agreement and why should an issuer sign the same agreement with a number of in exchanges? Why should a company comply with listing agreement with different exchanges or why should a number of exchanges monitor compliance by a company? There are about 10,000 companies listed on Indian exchanges.
Assuming that each company is listed on average on four exchanges there are 40,000 listing agreements, 40,000 sets of compliance by companies and the exchanges monitor 40,000 companies. It is just a waste of resources, as the terms are uniform across securities and across exchanges.

Every exchange exercises powers of listing/denial of listing, suspending/delisting of securities Reforming Securities Laws for Sustainable Development of Capital Market II independently. As a result, a security not found suitable for listing on an exchange gets listed on a different exchange, as they follow different criteria for listing a security. A prospective issuer informally gets a feedback from an exchange if the latter would consider listing of his security favourably. If he does not get an encouraging response, he tries his luck with other lenient exchanges. This creates an anomalous situation that a security, which is not suitable for investors in one locality, is suitable for investors in another locality. A security should either be suitable for listing on all exchanges or not suitable at all for listing on any exchange, that is, it should be suitable for all investors or not for any.

Given the speed of technological advances and trend in the market, extinction of a few stock exchanges is not a remote possibility. It is a normal market phenomenon that economic units come up and disappear due to market forces. But the exchange is just not an economic unit; it is a trustee for investors by virtue of being the listing authority. If an exchange, where a security is listed, disappears, the listing authority as well as the trading platform for the security disappears. Can a regulatory entity disappear for commercial reasons? This reinforces the argument that securities should be listed, but not listed on/by a particular stock exchange, but by a third party which would not be extinct for commercial reasons.
Listing signals that the issue has been properly supervised. The unwary investors take it as some kind of qualitative rating of the company, despite disclaimers to the contrary. Listing also casts onerous responsibilities on the exchange in the sense that it acts as a trustee for investors and ensures compliance of certain standards by a listed company. Most of the exchanges, given their financial health and organizational structure, are not in a position to supervise such large number of listed companies (9,644 companies listed on exchanges as at end of March 2002). Given their dependence on listing income, they can not discharge listing function efficiently. They can not easily deny a listing request nor can they suspend/delist a security without a second thought as they would not like offend a listed company in view of their interest. This therefore suggests the need for listing and supervision of a listed company through an independent authority who would not depend on listing income for survival.

The exchanges are now having a re-look at the way they conduct business and are gearing up to demutualise themselves by converting themselves into public limited companies. They will also be accessing securities market to finance their ever expanding trading network and would be interested to list their securities. This would create an anomalous situation where a stock exchange would admit its own securities for trading. A satisfactory solution would be to vest the listing powers with a body separate from the stock exchanges.

In view of the foregoing, it is desirable that there is only one agency which considers all requests for listing and grants listing if it finds a security suitable for investors across the country. A security granted listing by the agency would be available for trading on all exchanges who will not waste resources in terms of duplication of efforts on listing and monitoring compliance. The security should also be monitored, and suspended and withdrawn from trading by the listing
agency. The investors and market participants would get all the company related information, which are mandatorily required to be filed by companies, at one location preferably a web site maintained by the CLA. The exchanges should concentrate on trading only while pre-trading activity (listing and compliance of terms of listing) is managed by CLA and post trading activity (clearing and settlement of trades) is managed by clearing corporations.

5.27. PUBLIC HOLDING FOR LISTING

A public company seeking listing in recognized stock exchanges should satisfy the following criteria:

- the company should offer at least 10% of each class or kind of securities issued to the public for subscription. However, this requirement is subject to certain condition which are as followed:
- Minimum rupees 20 lakhs securities was offered to the public (excluding reservations, firm allotment and promoters contribution).
- The size of the offer to the public was minimum Rs.100 crore.
- The issue to be made through book building process.
- On allocation, 60% of the issue to the qualified institutional buyer (QIB's) as specified by SEBI.

On any circumstances or situations, in case if the above criteria is not able to maintained by the company they have got alternative solution which are as follows:

- The company should satisfy the stock exchange atleast 25% of each class or kind of securities offered to the public for subscription.
- On special circumstances, this requirements can be relaxed for government company. Moreover SEBI can relax or waive the strict enforcement of any requirement of listing.
The limitations of this framework:

- The public should have allotted shares. The law will speak about the terms of allotment, and not the public offer.
- The requirement (10% + 20 lakhs + Rs.100 crore) should also apply to the listing of units of CIS. The requirements may bring it par with those for securities.
- The units of mutual funds are being considered as securities and are being traded like securities on stock exchanges.
- There should not be any discrimination between a government company and a non-government company. The powers of the stock exchange to relax this requirement in respect of a government company needs to be withdrawn.

The powers of SEBI to relax or waive strict enforcement of listing requirement may also be withdrawn. (ii) The words 'public' or 'offer to public' have not been defined. The Rules permit 10% public offer subject to the condition that 60% of the issue is allocated to QIBs. Since QIBs are part of public, allocating 60% to QIBs would automatically constitute 60% public offer and the retail public would not get any share. Or, if 60% of public offer of 10% is allocated to QIBs, the retail public would be left with just 4%. It is, therefore, necessary to define 'public' and other terms and explicitly exclude allocation to QIBs from the public offer.

A large number of shares in the hands of a large number of shareholders is essential for sustenance of a continuous market for listed securities to provide liquidity to investors and to discover fair prices. The Act/Rules talk about offer to public, not about continuous public holding. To ensure availability of reasonable Floating stock on continuous basis, the listing agreement requires a company to
maintain the minimum level of non-promoter holding at the level of public shareholding at the time of listing. If the non-promoter holding of an existing listed company as on April 1, 2001 is less than that is required at the time of initial listing, the company shall within one year raise the level of non-public holding to at least 10%.

This arrangement prescribes different standards for continued listing for existing listed companies and would be listed companies. The existing listed company is required to have non-promoter holding of at least 10%, while the would be listed company would maintain non-promoter holding at the level of public holding as required at the time of listing, that is, at 10% plus 20 lakh securities plus Rs. 100 crore or 25%. Thus existing listed and would be listed companies and consequently investors in these companies are treated differently. It would be better if all the companies are required to maintain the non-promoter holding at the level of the public holding required at the time of listing. That is, the companies listed before 1993 would maintain at 60%, the companies listed between 1993 and 2001 would maintain at 25% and the companies listed after 2001 would maintain at 10% + 20 lakh + Rs. 100 crore or 25%. This is all the more desirable because the investor subscribes to the shares of the company based on the understanding that the non-promoter holding would be maintained at the level required at the time of listing. In the alternative, regulation has to be uniform in its application and all companies should be required to maintain non-promoter holding of 10% + 20 lakh + Rs. 100 crore or 25%.

Further, the listing agreement provides that the companies would maintain public holding at the specified percentage. There is no indication as to how to achieve this. Can a company compel the promoters to divest their holdings? In case an existing listed company fails to do; it would be required to buy back the
public shareholding in the manner provided in the SEBI takeover code. No such requirement has been prescribed for would be listed companies. Both the existing listed and would be listed companies should be required to buy back the public holding if they fail to maintain minimum public holding. In case the company does not buy back, would it be delisted? This needs to be clarified. All these Reforming Securities Laws for Sustainable Development of Capital Market need to be provided in the SCRA or Rules, not left to listing agreement.

5.28. DELISTING OF SECURITIES

The incident of de listing has been increasing over the years. It has assumed importance in view of a number of multinational companies acquiring the entire equity of the Indian subsidiaries through open offers.

It is argued that delisting should not be permitted as per legislators’ point of view. To restrict delisting of companies, SEBI has permitted voluntary delisting of securities. Major conditions for voluntary delisting include:

1. Company is not permitted to use the buy-back provision to delist the securities.
2. The amount of consideration for the tendered and accepted securities shall be settled in cash. The payment of consideration for delisting of securities shall be paid in cash by the promoter or acquirer.
3. Where securities are proposed to be delisted from all the stock exchanges and exit opportunity has been given to the investors for the purpose of which, an exit price shall be determined in accordance with a “Book Building process” described in clauses 7 to 10 and 13 & 14 of the delisting guidelines 2000.
4. In case of partly paid up securities, the price determined by the book building process shall be applicable to the extent, the call has been made and paid.

5. In case of infrequently paid securities, the offer price shall be as per regulation 20 (5) of the SEBI (substantial accusation of shares and take over). Regulations, and the infrequently traded securities shall be determined in the manner explained under regulation 20 (5) of the SEBI (substantial acquisition and take over) regulations.

6. The producer may not accept the securities at the offer price determined by the book building process. However, adequate disclosure may be made in public announcement and in the other letter/ form sent to the shareholders.

7. Whereas securities continue to be listed in the stock exchange having nationwide trading terminals, an exit opportunity need not be given. At present, SEBI has recognized the stock exchange, Mumbai and the national stock exchange as the first stock exchanges having nationwide trading terminals. However, SEBI has reserved the right to specify other stock exchanges as having nationwide trading terminals.

8. When a company, which is listed on any stock exchange, or stock exchanges other than BSE and/or NSE (i.e., Stock Exchanges having nationwide trading terminals), seeking delisting, and exit other shall be made to the share holders in accordance with delisting guidelines 2003. There shall not be any compulsion for the existing company to remain listed on any stock exchanges merely because it is a Regional Stock Exchange.

9. Before making the public announcement, the promoter shall appoint a merchant banker registered with a board, who is not an associate of the promoter.
10. Before making application for delisting, the promoters or the acquirers of the company shall make a public announcement.

In certain circumstances, delisting may serve interest of investors. If a company has been incurring losses and its net worth has become negative, there may not be any interest in the security. In this situation, if the company has to pay the listing fees, it harms the investor further, while no public interest or investor interest is served by continued listing. Or, if the security is allowed to trade, some innocent investors would be buying them and losing ultimately. It may also happen that a security is listed on many exchanges, but traded in a few. Payment of listing fees to exchanges where the security is not traded at all or traded insignificantly affects the investors ultimately. It may be desirable to allow a company to delist its securities in these cases.

In view of the above, it may not be desirable to put an absolute ban on delisting but it may be discouraged. The statute or rules must provide a framework for delisting. If it is in the interest of investors, it must be permitted. If it is not in the interest of investors, delisting maybe allowed only if investors are adequately protected. When a security at the time of issue carries an assurance that it would be listed on stock exchanges, it promises liquidity to security and hence carries a liquidity premium. This means that the security is issued at a price higher than what it would have been if it does not carry an assurance of listing. Since delisting withdraws the liquidity, the investors should be allowed get out with a premium. Non-compliance of listing agreement should not be a ground for delisting. The terms and conditions of listing have to be enforced by recourse to other means rather than delisting.
5.29. CLEARING CORPORATION

The anonymous order book does not allow participants to assess the counter party risk. It is, therefore, necessary that the exchanges use a clearing corporation to provide novation and settlement guarantee. NSCCL provides such novation for all trades executed on NSE. Similar facility should be provided for trades on other exchanges. It is not necessary that each stock exchange must have its own exclusive clearing corporation. It may be better if the stock exchanges use the services of a clearing corporation or a few clearing corporations, as they share the depository services. Such an arrangement allows the clearing corporation to have an overall view of gross exposure position of traders across the stock exchanges and is much better geared to manage the risk. However, to provide for necessary competition, it is essential that there are at least two clearing corporations, just as this has been ensured in the case of depositories.

The securities laws do not explicitly recognise existence of clearing corporation. They talk only about trading and not about settlement, which 30th National Convention of Company Secretaries is left to bye-laws of the exchanges. The bye-laws are supposed to provide for clearing house (not clearing corporation) for settlement of securities transactions. Except NSE, all exchanges have their departmental clearing houses. Risk management requires that all exchanges are required to use the services of a clearing corporation and this is mandated in law.

The clearing corporation ensures financial settlement of trades on the appointed day and time irrespective of default by members to bring in the required funds and/or securities, with the help of settlement Guarantee Fund'. The market has full confidence that the settlement shall take place in time and shall be completed irrespective of default by isolated trading members. This has revolutionised the volumes in the secondary market. It is important to keep
improving the value of the Settlement Guarantee Fund by adding back all the accruals to the fund, subject to administrative expenses, to retain and build up the faith that the retailing foreign investment have reposed in the settlement mechanism. For this purpose, it is necessary to exempt the income of the Clearing corporation from the purview of income tax is the clearing corporation guarantees financial settlement, it is necessary that it has first lien over the assets of insolvent clearing members

5.30. TAXABILITY OF INCOME ARISING FROM DERIVATIVE CONTRACTS

The Income Tax Act, 1961 does not have any specific provision regarding taxability of income from derivatives. Only provision in derivative transactions provides that any loss incurred by the assessee will not be set-off except under the head of profits and gains of business.

Section 43(5) of the Act has defined a speculative transaction as a transaction in which contract, purchase or sale of any commodity including stocks and shares, be traded in recognized stock exchanges, the transaction result may be profit or gain or even it may fetch a loss, but it excludes the following types of transactions:

➢ a contract in inspection of stocks and shares entered into by a dealer or investor there in to guard against loss in his holding of stocks and shares through price fluctuations.

➢ In forward market or in stock exchange any transactions held like jobbing or arbitrage to guard the loss, which may arise in the ordinary course of business as such member.
A transaction is thus considered speculative if:

1) It is in commodities, stocks & shares or scripts.
2) It is settled otherwise than by actual delivery.
3) It is not for jobbing, arbitrage and the participant has no underlying position.

Thus the law considers the same transaction becomes as speculative and non-speculative.

In the absence of a specific provision, it is apprehended that the derivative contracts, particularly the index futures/options which are essentially cash-settled, may be construed as speculative transactions. Therefore, the losses, if any, will not be eligible for set off against other incomes of the assessee and will be carried forward and set off against speculative income only up to a maximum of eight years. The fact, however, is that derivative contracts are not for purchase/sale of any commodity, stock, share or scrip. Derivatives are a special class of securities under the SCRA and do not in any way resemble any other type of securities like shares, stocks or scripts. Derivative contracts are cash-settled, as many of these (index options / futures) can not be settled otherwise.

The hedgers, speculators and arbitrageurs enter into derivative contracts. A derivative contract has any of these two parties and at least one of the parties is a hedger or an arbitrageur. Hence some, not all, of the derivative contracts have an element of speculation. Besides, hedgers and speculators are two sides of the same coin. Hedging is not possible if there are no speculators. The derivative market's capacity to absorb buying/selling by hedgers is directly dependent on availability of speculators to act as counter parties to hedgers. The derivative market can have liquidity only if it has speculative appeal. A competitive and efficient market
requires that all types of participants be provided a playing Field and their income from derivatives are taxed uniformly. The income from the same transaction should have similar tax treatment irrespective of the participant involved in it. This is all the more necessary as it is well neigh impossible to ascertain if a participant is trading for speculation, hedging or arbitrage. As a result, at times a hedging transaction is misconstrued as a speculative one. It is better to give benefit of doubt to exempt all speculative transactions than to misconstrue a hedging transaction as speculative. It is like acquitting hundreds of culprits rather than convicting a single innocent person. Attempts to differentiate transactions in commodities, share and stocks for speculative purposes have led in the past to a flood of litigation at the time of assessment.

A transaction is considered speculative, if a participant enters into a hedging transaction in scripts outside his holdings. It is possible that an investor does not have all the 30 or 50 stocks represented by the index. As a result investors’ profits and losses may be treated as speculative profits or speculative losses. This is contrary to the capital asset Pricing model. It states that portfolios do not contain any security in the index. The index derivatives are therefore used even for hedging the portfolio risk of non-index stocks. An investor who does not have the index stocks can also use the index derivatives to hedge against the market risk as all the portfolios have a correlation with the overall movement of the market (i.e. index).

As per the above mentioned speculative theory, the following major points to be considered as important:

(i) practical difficulties in administration of tax for different purposes of the same transaction,
(ii) inherent nature of a derivative contract requiring its settlement otherwise than by actual delivery,

(iii) need to provide level playing field to all the parties to derivatives contracts, and

(iv) need to promote derivatives markets, the exchange-traded derivatives contracts need to be exempted from the purview of speculative transactions. Otherwise it would be a penalty on hedging which the Securities Laws (Amendment) Act, 1999 seeks to promote. These must, however, be taxed as normal business income.

5.31. CONCLUSION

The introduction of computer-based trading and paperless shares, entry of foreign funds rolling settlement, banning of ‘badla’, and entry of derivatives have contributed to this transformation. The spice of the Indian Economic environment, 'the capital market' just got even spicier. The purpose of SEBI is achieved only when the Indian retail investor enters the market on a big way confidently.

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