CHAPTER 2: STOCK MARKETS IN INDIA: A PERSPECTIVE

In this chapter we trace the growth of Indian stock markets since its inception and note the measures that have improved its functioning. **Section 2.1** highlights the growth in the Indian capital market by looking at some statistics pertaining to the number of investors, market capitalization, trading volumes and turn-over ratios. In today's globalized world, investors can reduce their risk exposure by holding cross-country stocks in their portfolios. The increased role of Foreign Institutional Investors (FII), in the Indian market and the position of the Indian stock market in the securities market of the world is also noted in this section. **Section 2.2** gives a brief discussion of the growth profiles of the USA, UK and the Japanese Stock Exchanges. In **Section 2.3** we look at the growth of Indian stock exchanges from 1830 onwards. Establishment of Bombay Stock Exchange (BSE) in 1887, and National Stock Exchange (NSE) in 1992 are the milestones in the history of Indian capital market. In this section we also note the establishment of the Securities and Exchange Board of India (SEBI) and its role as the market watchdog. In **Section 2.4** we list some of the reform measures undertaken in the recent past. Finally, we note down the areas which still call for some changes to further improve the functioning of the Indian stock market in **Section 2.5**.

2.1 GROWTH IN THE CAPITAL MARKET

The process of liberalization and privatization started in the nineties increased the role of the private corporate sector in the Indian industrialization process. This growth of the corporate sector has been made possible due to the increased availability of savings. While the short-term funds come from banks, medium-term or long-term funds are either raised from the capital market or are borrowed from the long-term lending institutions like IDBI, ICICI etc. A sharp rise in the level of paid up capital is indicative of the increasing reliance of the corporate sector on the external source of finance. The share of capital market based instruments in resources raised externally, which was quite significant in the nineties, declined from 2001-02 onwards. This decline was due to the lack-luster performance of the secondary market. Of the two segments of the capital market, namely the primary market and the secondary market, it is the former in which the new capital is raised by the companies. The New Issue Market (NIM) or the primary market is thus very important from the point of economic growth. The secondary market on the other hand, is the market for old or already issued securities. The secondary market is composed of the exchange traded market and the OTC market. The OTC markets are informal markets where trades are negotiated and it covers most of the trade in government securities. The secondary market serves the important task of providing liquidity by enabling investors adjust their portfolio in response to changes in their assessment of risks and returns. By imparting liquidity and price stability to the securities it helps companies raise additional capital in the 'NIM' with greater ease. Thus, both the segments of the capital market are equally important from the point of view of supply of capital to the companies.

Over the years and particularly in the recent past, the capital market has contributed significantly to corporate growth (and economic development) not only in term of the quantum of funds but also in terms of the nature of funds provided to the corporate sector. The supply of funds to the capital market comes from individual savers, corporate savings, insurance companies, banks and other financial intermediaries. SEBI in association with National Council of Applied Economic Research (NCAER) conducted a survey of investors in 1998-99 and then followed it up in 2000-01. The survey estimated that a total of 13.1 million or 7.4% of all Indian households totaling 21 million individuals directly invested in equity shares or debentures or both during 2000-01. Though the percentage of investor households is very small the spurt in investors' interest acquires great significance when compared with the investor base of just about a million share holders in 1970. The survey also found that the number of debenture owning households and individual debenture holders far exceeds household and individual equity investors. Of the total 13.1 million investor households, 9.6 million households owned bonds or debentures, whereas only 6.5 million investor households owned equity shares. Further the percentage of households investing in equity or debentures is more in urban areas than in rural areas. This difference is more in case of equities compared to debentures.

The average annual capital mobilization from the primary market has grown manifold since the last two-three decades. It received a further boost during the first half of the nineties with the capital raised by non-governmental public companies rising sharply from Rupees 43,120 million in 1990-91 to Rupees 264,170 million in 1994-95. Thereafter, there has been a decline due to conditions prevailing in the secondary market. However, the year 2003-04 took a turn around in its performance as compared to the previous year by mobilizing Rupees 32,100 million. The capital raised, which used to be less than 1% of gross domestic savings in the 1970s, increased to about 13% in the 1992-93 but thereafter declined. Though there has been a considerable increase in the amount mobilized in 2003-04, when seen as a percentage of the gross domestic savings, it is a low 1.2%. Private placements which are the preferred form of raising resources accounted for 89% of total resources mobilized through domestic issues by corporate sector during 2003-04.

There are 23 exchanges in the country which offer screen based trading system, with NSE and BSE being the dominant players. All the exchanges follow a systematic settlement period. All the trades taking place over a trading cycle (day = T) are settled together on day T+2. There were 9368 trading members registered with SEBI at the end of March 2004.

The market capitalization has grown over the period indicating more companies using the trading platform of the stock exchange. The all India market capitalization is estimated at Rupees 13,187,953 million at the end of March 2004. The market capitalization ratio defined as the value of listed stocks divided by GDP increased sharply to 52.3% in 2003-04 against 28.5% in the previous year indicating a growth in the stock market size.

The trading volumes on exchanges have been witnessing phenomenal growth over the past decade. The trading volume which peaked at Rupees 28,809,900 million in 2000-01, fell substantially to Rupees 9,689,093 million in 2003-04. However the year 2003-04 notched an increase in trading volume to the tune of Rupees 16,204,977 million. 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 2003-04 was 122.9%. Most of the increase in turnover took place at the big exchanges. The NSE remained the market leader with more than 85% of total turnover (volumes on all segments) in 2003-04. The top five stock exchanges accounted for 99.88% of turnover and the rest 18 exchanges for less than 0.12% during 2003-04. About 10 exchanges reported nil trading volume during the year.

Along with the growth of the market there has been a change in the composition of investors over time. Foreign Institutional Investors (FII) with their financial might are increasingly registering their presence in the Indian stock market. Their increased prominence can be seen from the increase in the number of FIIs registered with SEBI. Institutional investors have also strengthened their position. Mutual funds (MF) have emerged as a safe investment vehicle for participating in the stock market. During the last decade the resources mobilized by mutual funds have increased from Rupees 112,440 million in 1993-94 to Rupees 476,840 million in 2003-04. This performance by MFs is the outcome of evolution of a regulatory framework for MFs, tax concessions offered by government and preference of investors for passive investing.

The Indian economy is getting integrated with the global market, though in a limited way, through Euro issues. Since they were permitted access in 1993, Indian companies have raised about Rupees 31,000 million through American Depository receipts/ Global Depository receipts.

As a result of the reform process, the Indian stock market is in a strong position vis-à-vis securities market of the developed and emerging markets. India has the number one ranking in terms of listed securities on the exchanges followed by the USA. India is also ranked very high in terms of turnover ratio, total value traded in stock exchanges and market capitalization. However, India's share in total world turnover and worldwide market capitalization is less than 1% as compared to the US share of around 50%. A major attraction for international investors is the relative price stability of Indian securities as compared to other foreign securities.

2.2 MAJOR STOCK MARKETS OF THE WORLD

The stock exchanges of the world differ in terms of size, structure and method of operation. As economies get integrated into a global economy regional stock exchanges strongly react to movements in major stock exchanges of the world. In addition to an understanding of the political, social and economic background of each country, knowledge of the development, structure and working of the principal stock exchange of the world is necessary for successful foreign investment. Further as much of the empirical work on finance is done in the context of major stock exchanges of the world like Nasdaq, the New York Stock

Exchange and the London Stock Exchange, an understanding of the working of these exchanges is essential.
The major stock exchanges in the US are Nasdaq, the New York Stock Exchange (NYSE) and the American stock exchange (AMEX).

National Association of Securities Dealers Automated Quotations (Nasdaq): The world's first and the largest US electronic stock market, it began trading in February 1971. With approximately 3,200 companies, it lists more companies and on an average, trades more shares per day than any other stock exchange in the world. It is home to companies that are leaders across all areas of business including technology, communications, financial services, media and biotechnology.

New York Stock Exchange (NYSE): The NYSE is the world's leading and the most technologically advanced equities market. It was founded in 1792 to facilitate the exchange of securities and bonds issued by several states and federal government to finance their war time debts. A broad spectrum of market participants including listed companies, individual investors, institutional investors and member firms created the NYSE market. The name NYSE was however adopted in 1863 only. By 1865, the NYSE moved to its present location in Wall Street. The volume of trading crossed the mark of 1 million shares in the year 1886.

Today NYSE has the reputation of a global market place. On an average day 1.46 billion shares valued at $ 46.1 billion trade on the NYSE. It is an integrated market that efficiently blends the best of floor based auction market trading and automatic execution.

The NYSE is governed by the Board of Directors (BOD) which is independent of NYSE management members and listed companies. The board which consists of 6 to 12 individuals, plus a chairman and a Chief executive officer (CEO), has full fiduciary responsibilities and supervises the exchange's regulation, governance, compensation and internal controls.

Apart from the BOD there is a separate board of Executives (BOE) consisting of 20 to 25 individuals representing NYSE constituents as well as NYSE chairman and CEO which advises the BOD. As a result of such open and transparent organizational structure and high level of participation by buyers and sellers, the NYSE is today one of the most competitive venue for trading its listed stocks, providing investors with the lowest cost, deepest liquidity and best prices.

The American Stock Exchange (AMEX): It stands second to the NYSE in terms of the volume of transactions. The AMEX is an auction market where trading is conducted through a centralized specialist system. By combining a specialist based auction market with state of the art trading technology- the foundation of a fair, efficient and accountable marketplace- all trades are executed swiftly with reliability, accuracy and transparency. By centralizing order flow and giving public orders priority over professional trading investors trade on a level playing field and the achieve the best price available. Trading is more orderly so price volatility is reduced, spreads are narrower and execution costs are lower.

The London Stock Exchange: One of the oldest stock exchanges in the world, in terms of number and range of national and international securities traded and in size of membership it occupies pre-eminent position. It has a very high ranking in terms of total value of transactions and has a broad and significantly free stock market. The large volume of business, longer trading period, easily available accurate information, a growing share owning population all these have contributed to a high degree of stability in the share price movements.

Due to the emergence of the joint stock companies, trading in stocks and share started in Britain in the 17th century. Legally the LSE was established in 1802. The LSE is governed by a set of rules and regulations which is published by the secretary to the council of the stock exchange. The council has 36 members of which, except the government broker, all are elected from and by the members of the stock exchange for a period of 3 years. In the administration of the stock exchange the council is assisted by various committees. In addition to the LSE there are four more stock exchanges in UK. All these exchanges are guided by the same rules and regulations.

Tokyo Stock Exchange (TSE): the TSE was established on 15th May 1878 and trading began on June 1st. The influence of World War II was seen in terms of the stock exchange being run as a war-controlled institutions and suspension of trading for a brief period.

On 1st April 1949, three stock exchanges were established in Tokyo, Osaka and Nagoya and a few more were added later on. The year 2000 saw some of the stock exchanges merge into TSE. On November 1 2001, TSE Inc. was established after dematerialization of TSE.

The TSE is run by a Board of Directors numbering 10, who take care of the actual management of the TSE. In order to increase the transparency and accountability of management to raise the legitimacy of operations and to fortify the board's supervisory function five of the directors are external board members. The BOD supervises business operations in accordance with corporate policies and is supported by advisory committees composed of market participants and third parties.

2.3 THE INDIAN STOCK MARKET - A BRIEF HISTORY

While the origin of Indian securities market may be traced back to 1875, trading activity in debt securities of East India Company is known to have started by the end of eighteenth century. By 1830, trading began in corporate securities mainly those of cotton presses and banks. The volume and value of business registered remarkable increase. The trading list further widened in 1839 and included securities of banks and business ventures like 'Bengal bonded warehouse docking Company' and the 'Steam Tug Company'. In 1850, the companies act was enacted which introduced the principle of limited liability. This period also witnessed the development of railways, telegraphs and improvement in communication systems. This led to the growth of joint stock companies. The brokerage business became attractive and by 1860 the number of brokers in Bombay increased to 60 from a mere 6 in 1850.

Between 1860 and 1865 there was a boom in the market for securities. The American civil war hindered the supply of cotton from US to Europe and consequently the demand for cotton from India rose. Cotton and cotton related industries went public to raise capital so as to expand their capacities and meet this increased demand. Exporters of cotton goods received bullion and this added to the wealth of Bombay. This wave of prosperity opened avenues for new ventures. The market price of almost all the securities (of both old and new ventures) commanded hefty premium between 1861 and 1865. In fact there was some sort of share mania during this period.

With the end of the American civil war the boom collapsed. The premium vanished and the price of the securities declined steeply. Companies went bankrupt and were dissolved. The investing public was left holding a huge mass of unsaleable papers. The worst came on 1st July 1865, which is popularly known as the 'Black Friday, when hundreds of bonds matured which no one was in a position to redeem.

The depression was long and severe and caused widespread desolations. The brokers, who were a privileged class during the boom time, were taken to be a social nuisance during the depression. They formed an informal association to protect their interests. Finally on 3rd December 1887, they formed a society which was to be India's first stock exchange. This stock exchange was formally established in Dalal Street in Bombay under the name of 'native share and stock brokers' association.

Like Bombay in Ahmedabad too the establishment of cotton textile units led to the creation of Ahmedabad share and stock brokers' association. The exchange was organized as a voluntary non-profit making association and followed the rules and practices prevalent in Bombay stock exchange.

The swadeshi movement in the 20th century gave birth to a new class of Indian entrepreneurs. Rapid development in transport and communication provided further impetus to industrialization. The Calcutta stock exchange association was formed on 15th June 1908, though it is reported that the trading business was carried on even as early as the end of the 18th century. In the initial years the exchange had to face a number of problems.

With the outbreak of World War I, the share prices again registered a rise. During the war the import of goods into India ceased and this gave the impetus to the domestic industry. Almost all enterprises earned profits and declared high dividends. The boom revived the interest of the public in the stock market.

The boom was over by 1921. Faced with foreign competition many domestic industries collapsed and share prices declined. Meanwhile on 6th April 1921, the Madras stock exchange was established. But it soon went out of existence being unable to withstand the severity of depression. Later in 1937 a stock exchange was established.

As already noted during the depression a large number of companies were liquidated leading to a huge waste of public money. In 1923 the government of Bombay appointed a committee under the chairmanship of Atley to look into the working of the BSE and suggest measures to improve its functioning.

The company reported that the chief weakness of BSE was laxity in administration. On its recommendation, the government of Bombay proposed to give monopoly of organized trading in securities to the BSE and in return wanted the rule making powers of the exchange to be vested with the authorities. However the exchange did not want any outside interference and turned down the offer. The government therefore, enacted the Bombay securities control act 1925 to protect the interests of the investing public. Through this act the government empowered itself the right to grant and withdraw recognition to a stock exchange. It also provided that rules and regulations of the stock exchange could only be made or amended subject to the government approval. BSE was granted official recognition on the 14th May 1927.

The 1925 act was however highly ineffective and failed to handle market position during the crisis in 1928, 1933, and 1935. This led to public criticism and demand for inquiry into the working of the BSE. Accordingly, the Morrison committee was set up in 1936, but its recommendations were not implemented due to the outbreak of World War II.

The war again gave a big boost to the stock exchanges. However in 1947 the stock market was in doldrums due to a number of factors like the RBI's directive asking scheduled banks to suspend the extension of credit against stocks and shares, threat of nationalization, spiralling prices and general political uncertainity.

In 1948, the government set up a departmental committee, the draft of which was referred to an expert committee headed by Mr. A. D. Gorwala. On the basis of recommendations of this expert committee, the government enacted the Securities Contract (Regulation) Act 1956. The act permits only those stock exchanges which have been granted recognition by the central government to function and empower the government to control, regulate and supervise the exchanges.

In the post-independent period many new stock exchanges were established. The Delhi stock exchange was established in 1947, followed by Bangalore stock exchanges in 1957 and Cochin 1979. In the eighties stock exchanges were established at Pune, Ludhiana, Guwahati and Patna.

Based on the recommendations of the Pherwani committee, NSE was promoted by leading financial institutions at the behest of the government of India to provide access to investors from all across the country on an equal footing. Unlike other stock exchanges in the country NSE was incorporated as a tax paying company in November 1992.

On its recognition as a stock exchange under the Securities Contracts (Regulations) Act 1956 in April 1993, NSE commenced operations in the wholesale debt market (WDM) segment in June 1994. The capital market (equities) segment commenced operation in November 1994 and operations in the derivative segment commenced in June 2000.

Today NSE is India's leading stock exchange covering various cities and towns across the country. The exchange has brought about unparalleled transparency, speed, efficiency, safety and market integrity. It has set up facilities that serve as a model for the securities industry in terms of systems, practices and procedures

Establishment of SEBI

A major reason for the general public shifting away from investing in stock market is the perception that stock exchanges function as a private club of the brokers. Sensing the need for the presence of watchdog to prohibit fraudulent and unfair trade practices relating to securities market and also check insider trading in securities, the government of India established the 'Securities and Exchange Board of India (SEBI) in April 1988. It was upgraded as a fully autonomous body (a statutory body) in the year 1992 with the passing of the SEBI act on 30th Jan 1992. The basic objectives of the board were identified as protecting the interest of investors and regulate and promote the development of the securities market.

SEBI has introduced comprehensive regulatory measures, prescribed registration norms the eligibility criteria the code of obligations and the code of conduct for different intermediaries like bankers to issue, merchant bankers, brokers and sub-brokers, registrars, portfolio managers, credit rating agencies, underwriters and others. It has framed by-laws, risk identification and risk management systems for clearing houses of stock exchanges, surveillance system etc., which has made dealing in securities both safe and transparent to the end investor.

2.4 REFORMS IN THE INDIAN SECURITIES MARKET

The securities scam of 1992 and 200-02 highlighted the loopholes in the system that has been exploited by manipulating brokers. With the objective of improving the market efficiency, enhancing transparency, preventing unfair trade practices and bringing the Indian market up to international standards many measures of reforms were undertaken. The market today uses state-of-the-art information technology to provide an efficient and transparent trading, clearing and settlement mechanisms and has witnessed several innovations in products and services via demutualization of stock exchange governance, screen based trading, compression of settlement cycles, dematerialization and electronic transfer of securities, security lending and borrowing, professionalization of trading members, fine tuned risk management systems, emergence of clearing corporations to assume counterparty risks, market of debt and derivative instruments and intensive use of information technology.

Some of the reform measures are noted below:

1. <u>DIP guidelines</u>: With the repeal of the Capital Issues (Control) Act 1947, in May 1992, governments control over issue of capital, pricing of the issues, fixing of premia and rates of interest on debentures etc. ceased. Thereafter the market has been allowed to allocate resources among the competing uses. In the interest of investors SEBI issued Disclosures and Investor Protection (DIP) guidelines. These guidelines contain a number of requirements for issuers/intermediaries with a broad intention to ensure that all concerned observe high standards of integrity and fair dealing. The guidelines also aim to secure fuller disclosure of relevant information about the issuer and the nature of the securities to be issued. This enables the investors' to take informed decisions. For example issuers are required to disclose any material 'risk factors' and give justification of pricing in their prospectus. The guidelines cast a responsibility on the lead managers to issue a due diligence certificate stating that they have examined the prospectus and it brings out all the facts and does not contain anything wrong on misleading. Issuers are now required to comply with the guidelines and then asses the market. The companies can access the market only if they fulfill minimum eligibility norms in terms of their track record of distributable profits and net worth.
2. <u>Screen based trading</u>: Prior to 1990s the trading on stock exchanges in India used to take place through an open outcry system. This system did not allow immediate matching or recording of trades. This was time consuming and imposed limits on trading. In order to provide efficiency, liquidity and transparency NSE introduced a nation-wide on-line fully automated screen based trading system (SBTS). In this system a member can punch into the computer quantities of securities and the prices at which he desires to transact and the transaction is executed as soon as it finds a matching sale

or buy order from a counter party. SBTS electronically matches orders on price/time priority and hence it cuts down on time and cost. It enables market participants to see the full market on real time basis, making the market transparent. It allows a large number of participants irrespective of their geographical locations to trade with one another simultaneously improving the debt and liquidity of the market. Following NSE other stock exchanges have also adapted SBTS.

3. Trading cycle: Initially the trading cycle varied from 14 days for specified securities to 30 days for others and settlement took another fortnight. Often this cycle was not adhered to and on several occasions led to defaults and risks in settlements. In order to reduce large open positions, trading cycle was reduced over a period of time to a week. The exchanges however continued to have different weekly trading cycles which enabled shifting of positions from one exchange to another. Rolling settlement on T+5 basis was introduced in respect of specified scrips reducing the trading cycle to one day. It was made mandatory for all exchanges to follow a uniform weekly trading cycle in respect of scrips not under rolling settlement. All scrips moved to rolling settlement from December 2001. The settlement period has been reduced progressively from T+5 to T+3 days. Currently T+2 days is being followed.

4. Derivatives trading: To assist market participants to manage risks better through hedging, speculation and arbitrage the ban on options on securities was lifted in 1995. However trading in derivatives took off much later after the suitable legal and regulatory framework was put in place. Derivatives trading commenced in June 2000 in the Indian securities market on NSE and BSE only. The market presently offers index futures and index options on three indices and stock options and stock futures on individual stocks and futures in interest rate products like notional 91-day T bills and notional 10 year bonds.

5. Demutualization: Historically, brokers owned, controlled and managed the stock exchanges. Therefore regulators focused on reducing the dominance of trading members in the management of stock exchanges. They advised them to reconstitute their governing councils to provide for at least 50% non-broker representation. However, this did not materially alter the

situation. In the face of extreme volatility in the securities market in 2000, the government proposed to corporatize the stock exchanges by which the ownership, management and trading membership would be segregated from one another. A few exchanges have already initialized demutualization process. NSE, for instance, has adopted a pure demutualized governance structure where ownership, management and trading are with three different sets of people and thus completely eliminating any conflict of interest.

6. Depositories Act: The physical settlement system gave rise to settlement risk. This was due to the time taken for settlement and due to the physical movement of papers. Further the transfer of shares in favor of the purchaser by the company also consumed considerable amount of time. To obviate these problems the Depositories Act, 1996, was passed to provide for the establishment of depositories in securities with speed and accuracy. This act brought in changes by: a) making securities of public limited companies freely transferable subject to certain exceptions; b) dematerializing of securities in the depository mode; and c) providing for maintenance of ownership records in a book entry form. In order to streamline both the stages of settlement process the act envisages transfer of ownership of securities electronically by book entry without making the securities move from person to person. In order to promote dematerialization the regulator has been promoting settlement in demat form in a phased manner in an ever-increasing number of securities.

The stamp duty in the transfer of demat securities has been waived. There are two depositories in India- National Securities Depository Limited (NSDL) and Central Depository Services Limited (CDSL). They have been set up to provide instantaneous electronic transfer of securities. At the end of March 2004 the number of companies connected to NSDL and CDSL were 5,212 and 4,720 respectively. The number of dematerialized securities increased to 97.70 billion at the end of March 2004 from 76.9 billion as of end March 2003.As on the same date, the value of dematerialized securities was Rs 10,701 billion and the number of investor accounts was 5,832,552. All actively traded scrips are held in demat form. Demat settlement accounts for over 9% of turnover settled by delivery. This has almost eliminated the bad deliveries and associated problems.

To prevent certificates from sneaking into circulation it has been made mandatory that all securities should be compulsorily traded in dematerialized form. The admission to a depository for dematerialization of securities has been made a prerequisite for making a public or rights issue or an offer for sale. It has also been made compulsory for public listed companies for making IPO of any security for Rupees 10 crores or more only in dematerialized form.

7. <u>Risk management</u>: with a view to avoid any kind of market failures, the regulator/exchanges have developed a comprehensive risk management system, which is constantly monitored and upgraded. It encompasses capital adequacy of members, adequate margin requirement, limits on exposure and turnover, indemnity, insurance, online position monitoring and automatic disablement etc. They also administer an efficient market surveillance system to detect and prevent price manipulation. The clearing corporation has also put in place a system which tracks online real time client level portfolio based upfront margining. Exchanges have set up trade/settlement guarantee funds for meeting shortages arising out of non-fulfillment/partial fulfillment of funds obligations by the members in a settlement. As a part of the risk management system, index based market wide circuit breakers have also been put in place. The National Clearing Corporation of India Limited (NSCCL) and Bank of Shareholding Limited (BOISL) clearing corporation houses of NSE and BSE, respectively, assume the counter-party risk of each member and guarantees settlement through a fine-tuned risk management system and an innovative method of on-line position monitoring. It also ensures the financial settlement of trades on the appointed day and time irrespective of default by members to deliver the required funds and/or securities with the help of a settlement guarantee fund (SGF). The SGF operates like a self-insurance mechanism wherein members contribute to the fund. In the event of failure of a trading member to meet his obligations, the fund is utilized to thee extent required for successful completion of the settlement. This has eliminated the counter-party risk of trading on the exchange.

8. Investor protection: To protect the interest of the investor SEBI has made it mandatory to disclose critical data in specified formats. The central government has established a fund called Investor Education and Protection Fund (IEPF) in October 2001 for the promotion of awareness amongst investors and protection of the interest of the investors. DEA, DCA, SEBI and the stock exchanges have set up investor grievance cells for redressal of investor grievance. The exchanges and DCA have all set up investor protection funds to take care of investor claims. All these agencies and investor associations organize investor education and awareness programs.

9. Globalization: Indian securities market is getting increasingly integrated with the rest of the world. Indian companies have been permitted to raise resources from abroad through issue of American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). Further foreign companies are allowed to invest in Indian companies. FIIs have been permitted to invest in all types of securities including governmental securities. The investments by FIIs enjoy full capital account convertibility. They can invest in a company under portfolio investment route up to 24% of the paid-up capital of the company. This can be increased up to the sectoral cap/statutory ceiling, as applicable. The Indian stock exchanges have been permitted to set up trading terminals abroad. The RBI has also permitted free conversion of ADRs/GDRs into underlying domestic shares and their re-conversion to ADRs/GDRs depending on the direction of price change in the stock. This increases liquidity in ADR/GDR market and aligns ADR/GDR prices with the company's domestic share prices.

2.5 SUGGESTIONS FOR FURTHER REFORMS

Though the above mentioned reform measures have given a competitive edge to the Indian stock markets in the global arena, further fine-tuning is required to keep up the momentum.

1. A large number of regional stock exchanges were set up in the post independence period to take care of regional aspirations. Most of these bourses however compete for the same set of securities through convoluted structures and subsidiaries that go against the concept of transparency and efficiency. The government should close smaller bourses which have no clear future or plans. Merging with a bigger stock exchange is also a viable alternative.
2. The recently launched Indonext should be actively promoted as a bourse with different structure and regulations that fulfills the need for a specialized market for small and medium stocks. Indonext can only work with highly innovative marketing and much greater investment by the bourses in market making, supervision and checking the background and business model of companies listed in this segment.
3. After the Initial Public Offerings (IPO) scam of 1992-1994, when companies vanished with investor's money, SEBI had come out with stringent disclosure norms so that retail investors can make informed decisions. It has also been suggested that SEBI form specific guidelines to regulate or prohibit prospectuses of dubious companies attempting to raise public money. However, it is now felt that IPO clearances cannot be based on disclosures alone and IPO ratings can prove useful in guiding investors. Such ratings should be by independent credit rating agencies, the cost of which can be borne by IEPF (Investor Education and Protection Fund). These ratings commissioned by IEPF will have the advantage of being independent of company influences. Moreover, as credit rating agencies will have to stake their reputation on a proper rating that ensures investor protection, investors will get a fair idea of the work of their investment.
3. The role of banking sector in various scams also makes it imperative for SEBI to have better coordination with the RBI to check the role of banks in aiding and abetting unscrupulous promoters.

4. Window dressing of financial statements of companies is another area that needs to be examined. Independent auditing of accounts of companies will improve the quality of information and allow investors to undertake investment decisions objectively.
5. The market regulator SEBI has also come in for lot of criticisms in its failure to prevent mal-practices in the market. SEBI badly needs to improve administration and accountability and restore its credibility as a powerful regulator. The justice M.H. Kania committee set up to suggest changes to the SEBI Act has made recommendations that clarify the rights and powers of the regulator. An important recommendation of this committee is to empower SEBI to file winding-up petitions against intermediary firms on the lines of powers available under the RBI act and the banking regulation Act.
6. Another noteworthy recommendation of the committee is to grant SEBI some power over the professionals to the extent that those caught indulging in malpractices or certifying false information can be barred from appearing in proceedings before the regulator.
7. It is also imperative that both stock exchanges and SEBI have well designed Management Information Systems. SEBI has to insure that its files and internal data bases are maintained accurately and efficiently. Though SEBI has granted Unique Identification Number (UIN) using biometric techniques for market participants, its data base is not properly maintained to provide names and address of brokers and sub-brokers.

Thus, these reform measures, if implemented, would improve the functioning of Indian stock markets and enable them to attract more funds both from domestic and foreign participants.