CHAPTER 1

INTRODUCTION

1.1. AN OVERVIEW OF FINANCIAL SERVICE SECTOR

The financial service sector accounts for a large and significant share of economic activity in most of the countries. This sector is recognized for its contribution towards the potential long-term growth and its intermediate role in channeling resources to all the other sectors of the economy. Improved provision of the financial services enables greater efficiency in other sectors by expanding the range and enhancing the quality of such services by lowering costs of funds, by encouraging savings and by the most efficient use of these savings. The financial services constitute a large and growing sector in almost all economy. Trade and investment flows in the financial services have been growing rapidly with the emerging and growing markets in the developing and transition economies, with modernization, rapid technological change, use of new financial instruments, and financial and trade liberalization.

The financial service sector which is large and complex covers a wide range of activities and instruments including, corporate banking, derivatives, factoring, foreign exchange trading, pensions and investment fund management, advisory and consultancy services, insurance broking and underwriting, project finance, securities trading, venture capital and the wholesale and retail banking services. Given the range of instruments and activities that fall under the purview of the financial services sector, there are also a large number of players involved in the financial services activities.
The financial services sector includes public and private sector banks, mutual funds, asset management companies, hedge funds, securities dealers and underwriters, foreign exchange dealers, pension funds, share brokering agencies, insurance firms and intermediaries and many other financial and non financial entities.

It is difficult to characterize the financial services sector in terms of its structural features and operating norms considering its complexity and range of operations. This problem is further compounded by the recent advances in information technology which has revolutionized the nature of operations in the financial sector, with the introduction of new kinds of financial instruments and players, the merging and integration of operations within and across players in this sector, reforms being undertaken in this sector around the world and the changing nature of regulation and regulatory structures in the financial services industry.

During the last decade, the equity markets have emerged as a critical source of capital for investment, growth and development, largely fuelled by the financial market liberalization policies. In the developing countries where there are market inefficiencies and institutional as well as resource constraints exists for financing, the equity market has become an important source of investment financing. There has been explosive growth of the developing countries’ equity markets in recent years, resulting in new patterns of foreign and domestic finance. There is a clear shift from sovereign borrowing and bank sources of finance to the direct funding from the capital markets. Liberalization has permitted companies to go overseas with global depository receipts and convertible bonds which enabled them in emerging markets to avail a wider menu of financing instruments.
Another major development in the global financial services sector is the emergence of new players and the increased diversity of players and the activities in the financial markets. While earlier, most financial intermediations were done through banks in 1970’s and 1980’s and the insurance companies and investment vehicles had well defined roles. Today many different kinds of institutions have emerged as financial intermediaries. These also include non-financial firms both wholesale and retail markets, which are playing a growing role in international markets. This increased diversity is also reflected in financial innovation and the emergence of new financial instruments including hybrid products such as annuities and derivatives. While reduced market segmentation is in part responsible for such financial innovations, advances in the processing of information and independent pricing of risk actors, which were previously bundled together have also fuelled the emergence of new financial instruments, particularly with reference to hedging and risk management.

There are two main forces driving the mentioned structural changes in the global financial services sector. The first is the deregulation and financial market liberalization. World over, there has been deregulation and reformation of the financial services sector, often as part of a larger package of economic reforms. The financial sector reform and deregulation have consisted of increased entry and competition by private entities, deregulation of interest rates, privatization of state owned financial institutions, reduced role of the government and public entities in credit allocation, and introduction of measures to liberalize the capital and equity markets. The liberalization policies have an important role in fostering integration within the financial sector of countries and in fostering integration of the financial systems across countries. Liberalization policies have played a functional role in the development of trends like universal banking, non-bank financial institutions, and debt and equity markets.
A second factor underlying the structural changes in the global financial services sector is the technological progress. Technological advancements have led to the introduction of a whole new range of competitors. Innovations in the form of electronic data processing and transmission, automatic teller machines, tele-banking, smart cards, and internet-based banking services have increased the scope for retailing in the financial sector, providing direct access to the customer. There have also been major changes in the stock exchanges with the dematerialization of scrip and replacement of floor trading by computerized trading and electronic settlement and clearing of securities and derivatives transactions.

Overall, financial sector deregulation and technological innovation have increased the size of cross-border activity and promoted international integration in the financial services, widened the choice of services, instruments and institutions available to users and increased the capability of the financial service providers (FSPs) to meet their customers' financial needs.

1.2. REGULATORY ISSUES AND DEVELOPMENTS IN THE FINANCIAL SERVICES SECTOR

The financial services sector is one of the most heavily regulated sectors in most economies, given its central economic role. There are several major regulatory concerns that are addressed by prudential regulations in the financial sector. These include objectives of safety and soundness of the financial system and its integrity, limiting systemic risk, providing for consumer and investor protection and promoting competition. For instance, there are typical rules with regard to capital adequacy, exposures, currency matching, financial reporting, and risk management and management information systems to ensure the safety and soundness of the financial
There are also arrangements to provide financial compensation to consumers and investors who incur losses due to failure or misconduct of a financial service provider as well as regulations governing standards of conduct and practices of financial service providers such as through disclosure and transparency norms. In addition, capital market controls may be used to regulate the financial sector and limit integration with global markets.

The evolving structure of the global financial services industry and increased integration of financial markets pose major regulatory challenges for the financial services sector. Growing cross border flows of financial services due to the rapid growth in e-commerce and internet based financial transactions are creating problems for regulatory authorities as financial service providers no longer fall within their easy control and because there is greater scope for fraudulent transactions, and the fact that cross border financial flows are more rapid. Moreover, there are additional regulatory challenges due to growing financial sector innovation and the emergence of hybrid financial transactions. Such trends are causing a shift in thinking about what would constitute an appropriate regulatory paradigm for the financial services sector.

At present, most countries, and in particular the developing countries have multiple regulators, with varying modes of coordination among the different specialized regulatory agencies. Regulation is mainly on a functional basis with different agencies regulating different functions, such as securities, insurance, and banking. However, there is an emerging paradigm shift advocating a move towards a single financial sector regulator or a consolidated supervisory and regulatory authority. According to this view, a single regulator approach would help streamline regulation and associated inefficiencies and also enable the benefits of scale and scope in
regulation, which are necessitated by the growing consolidation and innovation within the financial sector.

While there has been some debate that the financial markets in the developing countries may not be mature enough to warrant the introduction of a super regulator, an emerging point of view is that multiple regulators prevent financial sector innovation and consolidation. The absence of a single regulator is also seen as resulting in higher costs of operation and duplication of administration, inefficacy in preventing unethical practices, and conflict of interest among different regulatory agencies. The emerging consensus is that a single regulatory authority would be able to function in a more transparent and accountable manner, that it would enable more effective response to market innovation and developments, better pooling of supervisory resources, and greater integration and coordination within the financial sector. Many developing country experts propose that the central bank should assume the responsibility of the super regulator.

Regulatory challenges in the financial system will continue to grow with the blurring of different types of the financial activities and institutions, with the growing integration of capital markets and volatility of capital flows across economies, and the increasing difficulty in distinguishing between prudential and consumer protection responsibilities of regulators. More and more countries are likely to move towards a super regulator type paradigm.

1.3. INDIAN STOCK MARKET

1.3.1. Pre-Independence Period

The Indian stock market is one of the oldest stock market in Asia. Its history dates back to nearly 200 years ago. The earliest records of security dealings in India are meager and obscure. The East India Company was the
dominant institution in those days and business in its loan securities used to be transacted towards the close of the eighteenth century. Bombay became the major centre of trading activity in securities. This trading activity was unorganized and informal in nature. In Bombay, by 1830, some bank shares also entered into the trading place. These shares included the Commercial Bank, the Chartered Mercantile Bank, the Agra Bank, the Oriental Bank and the Bank of Bombay. Between 1840 and 1850, there were half a dozen of stock brokers in Bombay recognized by banks and merchants. By 1860, the numbers of brokers increased to 60. With the passing of the Joint Stock Companies Act in 1850, the number of companies involved in various types of trades started growing.

Since the Britishers were ruling the country at that time, most of provisions of the Company Act, 1850 and subsequent company acts were closely related to the British Company Law. At that time all important decisions relating to Indian economy were either taken or influenced by the Britishers. The British interests exploited the Indian industry through “unequal trade by making India a hinterland for the production and sale of raw materials and purchase of metropolitan manufactures”. The emergence of stock exchange in India has close links with the “Cotton Boom” that took place during 1860 to 1865 in Bombay. Nearly all the cotton produced in South India had to pass through Bombay on its way to Britain.

A large amount of cotton exports was paid for in the form of bullion that poured into Bombay in the shape of Gold and Silver. Available fact indicates that speculation in securities and establishing new companies were two of them. Speculation can be termed as the purchase of securities (or temporary sales) for later resale (repurchase) in the hope of profiting from the intervening changes. From 1861 to the beginning of 1865, speculation was the key activity in Bombay’s securities trading places. After the end of the
American Civil War in the early 1865, the sources of huge earnings dried up. Then, the speculative activities were interpreted by non-fulfillment of transactions. The number of brokers dealing in securities should be about 60 by 1860 to 200-250 during the cotton boom period.

Between 1863 and 65, 25 new banks, 69 financial associations, seven land reclamation companies and 30 miscellaneous companies were floated. After 1865, a number of financial failures and problems in speculative activity led brokers to form an association in 1875 and it is today called as the Bombay Stock Exchange. Security dealers in Ahmedabad and Calcutta also shared the cotton boom in terms of intense speculative activity. The Bombay experience was latter followed at these centers, with stock exchanges being set up in Ahmedabad in 1894, at Calcutta in 1908, at Indore in 1930, at Madras in 1937, at Hyderabad in 1943 and at Delhi in 1947.

Since the beginning, the Bombay Stock Exchange is considered as the leader of the Indian Stock Exchanges. Therefore, trends and developments that have taken place there can be treated as broad indicators of performance of stock exchanges in the country. Stock exchanges or share bazaars are commonly associated in the popular minds with real industrial financing. As they function today in India and taken at their best, they are organized markets for buying and selling existing industrial stocks, shares and debentures.

Stack exchanges also deal in securities which absorb inconsiderable proportion of total investment in the community wealth. It is also worth mentioning that functioning, organization and management of seven out of 23 exchanges including that four of the Indian five major stock exchanges Bombay, Calcutta, Delhi, Ahmedabad and Madras took shape during the pre-independence period marked for absolute domination of speculative interests.
Organization and management of major stock exchanges formed during this period did not prove to be positive to the developments and desirable changes later more particularly during the period of eighties.

1.3.2. Post-Independence Period

Most of the exchanges suffered almost a total eclipse during the depression. The Lahore exchange was closed during the partition of the country and later migrated to Delhi and merged with the Delhi Stock Exchange. The Bangalore Stock Exchange Limited was registered in 1957 and recognized in 1963. Most of the other exchanges languished till 1957 when they applied to the Central Government for recognition under the Securities Contracts (Regulations) Act, 1956. Only Bombay, Calcutta, Madras, Delhi, Ahmedabad, Hyderabad and Indore, the well established exchanges were recognized under the act. Thus, during early sixties, there were eight recognized stock exchanges in India. The number virtually was unchanged, for nearly two decades.

National Stock Exchange of India Limited (NSEIL) are also operating in the country.

During 1973-80, the FERA legislation virtually ensured that many well managed companies offered their equities to the public at regulated low prices. During this period, stock market exhibited an upward trend with share prices displaying high level buoyancy. The Indian capital market really developed from the mid-1980s with the introduction of the new economic policy. At that time, debentures and public sector bonds emerged as powerful instruments of resource mobilization in the primary capital markets. Consequently, secondary market also began to grow faster from that time. The number of stock exchanges, the number of listed companies on stock exchanges, their market capitalization and the value of trading shares increased significantly.

The most outstanding development in the Indian share market during the eighties is that share ownership has become a middle class phenomenon. Nearly 40 per cent of the educated middle and upper class households have come to hold shares or debentures. These share owners tend to have long term investment interests and they have held the shares for more than three years and one fourth of share holders have shareholdings that exceed more than 10 years. The unprecedented growth of Indian share markets has resulted in these markets becoming a major market in the emerging stock market in the World, next only to Taiwan and Korea, both in respect of market capitalization and turn over. Thus, the Indian capital market has been always perceived as deep, resourceful and resilient.
1.4. STOCK MARKET AND LIBERALIZATION

The liberalization encompassed wide ranging measures, a few being delicensing of a number of industries; throwing open to the private sector a number of industries reserved for the public sector; the lowering of personal and corporate tax rates; raising of the interest rate convertible debentures of companies; raising the asset limit for applicability of the Monopolies and the Restrictive Trade Practices Act (MRTP); bringing in more items under the Open General Licences (OGL); liberal approach in regard to foreign collaborations; allowing scope for dominant undertakings to go in for diversification.

The liberalization also included special incentives for private enterprise by way of reduction in direct taxes and tax free high yielding instruments without any financial limit on individual subscriptions. The sharp increase in the number of public limited companies in private corporate sector can also be viewed in the context of company law provisions that allow public limited companies to raise money from public. During 1980-90 an increase of 132 per cent in the number of public limited companies was registered as compared to an increase of only 38 per cent during the decade of 1970-80.

With liberalization and increased demands for funds on the part of private corporate sector, investment in shares and debentures became a middle class phenomenon. In June 1991, in the midst of severe fiscal and external imbalances, which had generated double digit inflation and put the country on the verge of defaulting on its external debt obligations, a government undertook the major task of stabilizing and liberalizing the economy. Since 1991, reforms of the investment, exchange rate and trade regimes had ended four decades of State planning and setting in motion virtually a quite economic revolution.
Before 1992, many factors obstructed the expansion of equity trading. Fresh capital issues were controlled through the Capital Issues Control Act. Trading practices were not transparent, and there was a large amount of insider trading. Recognizing the importance of increasing investor protection, several measures were enacted to improve the fairness of the capital market. The Securities and Exchange Board of India (SEBI) was established in 1988. Despite its rules problems continued to exist, including those relating to disclosure criteria, lack of broker capital adequacy, and poor regulation of merchant bankers and underwriters.

There have been significant reforms in the regulation of the securities market since 1992 in conjunction with overall economic and financial reforms. In 1992, the SEBI Act was enacted giving the SEBI statutory status as an apex regulatory body. And a series of reforms was introduced to improve investor protection, automation of stock trading, integration of national markets, and efficiency of market operations. India has witnessed a tremendous change in the secondary market for equity. Its equity market will be comparable with the world’s most advanced secondary markets within a year or two. The key ingredients that underlie market quality in India’s equity market are:

- Exchanges based on an open electronic limit order book
- Nationwide integrated market with a large number of informed traders and fluency of short or long positions
- No counterparty risk.

Among the processes that are fully implemented are electronic settlement trade and exchange-traded derivatives. Before 1995, markets in India used open outcry, a trading process in which traders shouted and hand signaled from within a pit. One major policy initiated by the SEBI from 1993
involved the shift of all exchanges to screen-based trading, motivated primarily by the need for greater transparency. The first exchange to be based on an open electronic limit order book was the National Stock Exchange (NSE), which started trading debt instruments in June 1994 and equity in November 1994. In March 1995, BSE shifted from pen outcry to a limit order book market. Currently, 7 of India’s stock exchanges have adopted an open electronic limit order.

Before 1994, India’s stock markets were dominated by the BSE. In other parts of the country, the financial industry did not have equal access to markets and was unable to participate in forming prices, compared with market participants in Mumbai (Bombay). As a result, the prices in markets outside Mumbai were often different from prices in Mumbai. These pricing errors limited order flow to these markets. Explicit nationwide connectivity and implicit movement toward one national market has changed this situation. The NSE has established satellite communications which give all trading members of the NSE equal access to the market. Similarly, the BSE and the Delhi Stock Exchange are both expanding the number of trading terminals located all over the country. The arbitrages are eliminating pricing discrepancies between markets.

Despite these big improvements in microstructure, the Indian capital market has been in decline during the mid to late 1990’s. A leading cause was that financial irregularities and overvaluations of equity prices in the earlier years had eroded public confidence in corporate shares. There was a reduced inflow of foreign investment after the Mexican and Asian financial crises. The market is now undergoing a period of adjustment.

The SEBI has announced several far-reaching reforms to promote the capital market and protect investor interests. Reforms in the secondary
market have focused on three main areas: structure and functioning of stock exchanges, automation of trading and post trade systems, and the introduction of surveillance and monitoring systems. Computerized online trading of securities and setting up of clearing houses or settlement guarantee funds were made compulsory for stock exchanges.

The stock exchanges were permitted to expand their trading to locations outside their jurisdiction through computer terminals. Thus, major stock exchanges in India have started locating computer terminals in remote areas, while smaller regional exchanges are planning to consolidate by using centralized trading under a federated structure. Online trading systems have been introduced in almost all stock exchanges. Trading is made more transparent and quicker than in the past. Until the early 1990’s, the trading and settlement infrastructure of the Indian capital market was poor. Trading on all stock exchanges was through open outcry, settlement systems were paper-based, and market intermediaries were largely unregulated. The regulatory structure was fragmented and there was neither comprehensive registration nor an apex body of regulation of the securities market.

The stock exchanges were run as “Brokers clubs” as their management was largely composed of brokers. There was no prohibition on insider trading, or fraudulent and unfair trade practices. Since 1992, there has been intensified market reform, resulting in a big improvement in securities trading, especially in the secondary market for equity. Most stock exchanges have introduced online trading and set up clearing houses/corporations. A depository has become operational for scripless trading and the regulatory structure has been overhauled with most of the powers for regulating the capital market vested with the SEBI.
The Indian capital market has experienced a process of structural transformation with operations conducted to standards equivalent to those in the developed markets. It was opened up for investment by the foreign institutional investors (FIIs) in 1992 and Indian companies were allowed to raise resources abroad through the Global Depository Receipts (GDRs) and the Foreign Currency Convertible Bonds (FCCBs). The primary and secondary segments of the capital market expanded rapidly, with greater institutionalization and wider participation of individual investors accompanying this growth. Many problems, including lack of confidence in stock investments, institutional overlaps, and other governance issues, remain as obstacles to the improvement of the Indian capital market efficiency.

With the increased application of information technology, the trading platforms of all the stock exchanges are accessible from anywhere in the country through their trading terminals. However, the trading platform of the NSE is also accessible through internet and mobile devices. In a geographically widespread country like India, this has significantly expanded the reach of the exchanges to the homes of ordinary investors and assuaged the aspirations of people to have exchanges in their vicinity.

As a result of the reform/initiatives taken by the Government and the Regulators, the market microstructure has been refined and modernized. The investment choices for the investors have also broadened. The securities market moved from T+3 settlement periods to T+2 rolling settlement with effect from April 1, 2003. Further, straight through processing has been made mandatory for all institutional trades executed on the stock exchange. Real time gross settlement has also been introduced by the RBI to settle inter-bank transactions online at real time mode. These developments in the securities market provide the necessary impetus for growth and development, and thereby strengthen the emerging market economy in India.
1.5. MARKET SEGMENTS

The securities market has two interdependent segments: the primary and the secondary market.

1.5.1. Primary Market

The primary market is the channel for creation of new securities. These securities are issued by public limited companies or by government agencies. In the primary market the resources are mobilized either through the public issue or through private placement route. It is a public issue if anybody and everybody can subscribe to it, whereas if the issue is made available to a selected group of persons it is termed as private placement. There are two major types of issuers of securities, the corporate entities who issue mainly debt and equity instruments and the government (central as well as state) who issue debt securities. These new securities issued in the primary market are traded in the secondary market.

1.5.2. Secondary Market

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risks and returns. The secondary market operates through two mediums, namely, the over-the-counter (OTC) market and the exchange-traded market. The OTC markets are informal markets where trades are negotiated. Most of the trades in the government securities are in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The other option is to trade using the infrastructure provided by the stock exchanges. There are 23 exchanges in India and all of them follow a systematic settlement period. All the trades taking place over a trading cycle (day=T) are settled together after a certain time (T+2 day).
The trades executed on the National Stock Exchange (NSE) are cleared and settled by a clearing corporation. The clearing corporation acts as a counterparty and guarantees settlement. Nearly 100% of the trades in the capital market segment are settled through demand delivery. The NSE provides a formal trading platform for trading of a wide range of debt securities, including government securities. A variant of the secondary market is the forward market, where securities are traded for future delivery and payment. A variant of the forward market is Futures and Options market. Presently only two exchanges viz., the NSE and the Stock Exchange, Mumbai (BSE) provides trading in the derivatives of securities.

1.5.3. Stock Broking

The history of stock brokers can be traced back to the origins of the first stock exchange in 1602 at Amsterdam. Even before that brokers have existed in France dealing with government securities. The Amsterdam Stock Exchange was involved in buying and selling of shares for the Dutch East India Company. However, the first real stock exchange came up in Philadelphia in the United States during the late 18th century. Later it was the New York stock exchange which saw a rise in its popularity. Wall Street, as it was later called, became the hub of brokerage activities.

1.5.4. Stock Broking in India

The functioning of stock broking in India was started in 1875. The BSE is the oldest stock broking of India. The History of Indian stocks trading started with the 318 person taking membership in Stock Brokers Association and Native Share, known by the name as Bombay Stock Exchange (BSE). During the year 1965, BSE got a permanent acknowledgment from Government of India. Till the 1980's stock broking services were used only by
the wealthy class who could afford them. With the advent of the Internet, stock broking became very easy and flexible.

Table 1.5.4. Growth of Stock Brokers in India

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Stock Brokers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994-95</td>
<td>6711</td>
</tr>
<tr>
<td>1995-96</td>
<td>8476</td>
</tr>
<tr>
<td>1996-97</td>
<td>8867</td>
</tr>
<tr>
<td>1997-98</td>
<td>9005</td>
</tr>
<tr>
<td>1998-99</td>
<td>9069</td>
</tr>
<tr>
<td>1999-00</td>
<td>9192</td>
</tr>
<tr>
<td>2000-01</td>
<td>9782</td>
</tr>
<tr>
<td>2001-02</td>
<td>9687</td>
</tr>
<tr>
<td>2002-03</td>
<td>9,519</td>
</tr>
<tr>
<td>2003-04</td>
<td>9,368</td>
</tr>
<tr>
<td>2004-05</td>
<td>9,062</td>
</tr>
<tr>
<td>2005-06</td>
<td>9,062</td>
</tr>
<tr>
<td>2006-07</td>
<td>9,384</td>
</tr>
<tr>
<td>2007-08</td>
<td>9,428</td>
</tr>
<tr>
<td>2008-09</td>
<td>8,652</td>
</tr>
<tr>
<td>2009-10</td>
<td>8,804</td>
</tr>
<tr>
<td>2010-11</td>
<td>9235</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report 2010-11

There were 9,235 registered stock brokers in the country in the cash segment during 2010-11 against 8,804 2009-10, as per SEBI's annual report 2011. During 2010-11, 531 new stock brokers were registered with SEBI in cash segment whereas there were 100 cases of cancellation/ surrender of broker ship during the year 2010-11 as compared to 312 and 160, respectively in 2009-10. The total number of registered stock brokers as on March 31, 2011, increased to 9,235 from 8,804 in 2009-10. The number of registered brokers was highest in National Stock Exchange Ltd, (1,389) followed by
Bombay Stock Exchange Ltd. (1,301), Inter-Connected Stock Exchange (ISE) (943) and Calcutta Stock Exchange (901). The number of corporate brokers was also highest in NSE (1,239) followed by BSE (1,087) and OTCEI (536).

Corporate brokers constitute 89.20 percent of the total stock brokers at NSE whereas the corporate brokers constituted 83.55 percent and 76.46 percent at BSE and OTCEI, respectively. The number of corporate brokers as a percentage of total brokers was more than 50 percent in five out of 19 recognized exchanges. Highest number of stock brokers in ‘proprietorship’ category was at Calcutta stock exchange (656), followed by ISE (566). NSE had the lowest number of brokers in proprietorship category (73) which was 5.26 percent of the total stock brokers registered with NSE. Stock brokers in ‘partnership’ category were highest in NSE (77), followed by Calcutta Stock Exchange Ltd (44). Bhubaneswar and Coimbatore stock exchanges did not have any brokers in the ‘partnership’ category.
1.5.5. COIMBATORE STOCK EXCHANGE LIMITED

The Coimbatore Stock Exchange Limited, (CSX) is located in Coimbatore, Tamilnadu, India. It is the youngest stock exchange in India and was founded by K.G. Balakrishnan. The Exchange has successfully implemented the Screen Based Trading (SBT) system and commenced its operations with effect from 9\textsuperscript{th} October, 1996. The system is capable of handling 25000 trades per day. All the members of the Exchange are connected in a Local Area Network (LAN). The system can be expanded to handle up to 400 members.

The SBT system has been interfaced with the existing settlement system. The margins are monitored online on the SBT system. Each member is given a computer terminal, telephone connection which is accommodated in a cubicle. The communication facilities include the terminals of Reuters and Knight Ridde that are constantly updating the economic and the capital market related news. CSX is the youngest Stock Exchange in India. The CSX was founded by K. G. Balakrishnan (founder president) and his group and is now governed by the Governing Board consisting of the member brokers. Currently the segregation of Coimbatore Stock Exchange is as follows:

- Individual Members - 136
- Corporate Members - 57
- Chartered Accountants/ Company Secretaries - 40
- MBAs - 17
- Engineers - 14
- Cost Accountants - 10
- Post Graduates – 25

Coimbatore Stock Exchange provides well equipped facilities to its members and investors. The facilities are library, canteen, and spacious
parking area, telephone and Internet booths, bank with security lockers, conference hall, gymnasium and other necessary services.

In the near future, the exchange is planning for the implementation of Interconnected Stock Exchange to promote more business to the centre. Apart from the infrastructure, the exchange is planning for the set up of a Training Academy, Software Development, Research Centre and other useful activities. It also has a plan to set up Additional Trading Floor (ATF) which will bring more traffic to the CSE building. Wide Area Networks through VSATs are also in the offing.

1.6. REGULATORY FRAMEWORK

The four main legislations governing the securities market are (a) The SEBI Act, 1992 (b) The Companies Act, 1956 (c) The Securities Contracts (Regulation) Act, 1956 and (d) The Depositories Act, 1996. A brief about these legislations are as given below:

1.6.1. SEBI Act, 1992

The SEBI Act, 1992 was enacted to empower the SEBI with statutory powers for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. Its regulatory jurisdiction extends over corporates in the issuing capital and all intermediaries and persons associated with securities market. It can conduct enquiries, audits and inspection of all concerned participants and adjudicate offences under this Act. It has powers to register and regulate all the market intermediaries. Further it can also penalize them in case of violations of the provisions of the Act, Rules and Regulations. The SEBI has full autonomy and authority to regulate and develop an orderly securities market.
1.6.2. Securities Contracts (Regulation) Act, 1956

It provides for direct and indirect control of virtually all aspects of the securities trading including the running of stock exchanges with an aim to prevent undesirable transactions in securities. It gives the Central Government regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. As a condition of recognition, a stock exchange complies with the requirements prescribed by the Central Government. The stock exchanges frame their own listing regulations in consonance with the minimum listing criteria set out in the Rules.

1.6.3. Depositories Act, 1996

The Depositories Act, 1996 provides for the establishment of depositories for securities to ensure transferability of securities with speed, accuracy and security. For this, these provisions have been made: (a) making securities of public limited companies freely transferable subject to certain exceptions; (b) dematerializing the securities in the depository mode; and (c) providing for maintenance of ownership records in a book entry form. In order to streamline the settlement process, the Act envisages transfer of ownership of securities electronically by book entry without moving the securities from persons to persons. The Act makes the securities of all public limited companies freely transferable, restricting the company’s right to use discretion in effecting the transfer of securities. The transfer deed and other procedural requirements under the Companies Act have been dispensed with.

1.6.4. Companies Act, 1956

It deals with issue, allotment and transfer of securities and various aspects relating to company management. It provides for standards of disclosure in the public issues, particularly in the fields of company
management and projects, information about other listed companies under the same management, and management perception of risk factors. It also regulates underwriting, the use of premium and discounts on issues, rights and bonus issues, payment of interest and dividends, supply of annual report and other information.

1.6.5. Rules, Regulations and Regulators

The Government has framed rules under the SCRA, the SEBI Act and the Depositories Act. The SEBI has framed regulations under these acts for registration and regulation of the market intermediaries and for prevention of unfair trade practices. Under these Acts, the Government and the SEBI issue notifications, guidelines and circulars, which the market participants comply with. The SROs like the stock exchanges have also laid down their rules and regulations. The regulator has to ensure that the market participants behave in a desired manner so that securities market continue to be a major source of finance for corporate and government while protecting the interest of investors. The responsibility for regulating the securities market is shared jointly by the Department of Economic Affairs (DEA), the Department of Company Affairs (DCA), the Reserve Bank of India (RBI) and SEBI.

The activities of all these agencies are coordinated by a High Level Committee on Capital Markets. Most of the powers under the SCRA are exercisable by the DEA while a few others by SEBI and some are concurrently by them. The regulation of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently with the RBI.
The SEBI Act and the Depositories Act are mostly administered by the SEBI. While the rules under the securities laws are framed by government, regulations are framed by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by the SEBI in case of listed public companies and public companies proposing to get their securities listed. The SROs ensures compliance of market participants with their own rules as well as with the rules relevant for them under the securities laws.

1.7. PRODUCTS AND PLAYERS

Mobilization of savings from surplus savers to deficit savers is most efficiently carried out by the securities market through a range of complex products called “securities”. The definition of securities as per the SCRA, 1956 includes shares, bonds, scrips, stocks or other marketable securities of like nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, interest and rights in securities, security receipt or any other instruments so declared by the central government.

The securities market has essentially three categories of participants, viz., the issuer of securities, investors in securities and the intermediaries. The issuers are the borrowers or deficit savers, who issue securities to raise funds. The investors, who are surplus savers, deploy their savings by subscribing to these securities. The intermediaries are the agents who match the needs of users and suppliers of funds for a commission.

These intermediaries pack and unpack securities to help both the issuers and investors to achieve their respective goals. There are a large variety and number of intermediaries providing various services in the Indian
securities market. This process of mobilization of resources is carried out under the supervision and overview of the regulators. The regulators develop fair market practices and regulate the conduct of issuers of securities and the intermediaries. They are also in charge of protecting the interests of the investors. The regulator ensures a high service standard from the intermediaries and supply of quality securities and non-manipulated demand for them in the market.

Share brokers are the persons or firms who execute buy or sell order on behalf of the investors and charge a commission for rendering the service. They are the important constituent of the whole share trading process. The transaction between the share broker and members of a stock exchange takes place on a net basis where the stock exchange itself acts as the counter-party to every transaction.

Share brokers offer two types of share trading viz., offline share trading and online share trading. Off line share trading is a form of trading in which the customer either goes to share broker’s place and sits before the share trading terminal and asks the dealer to place orders in his account or rings the share broker, asks the share quotes and other relevant information and accordingly place orders over the phone. Online share trading is one in which the client could avail the share market and could place his order from any place he wants, provided he has a computer with an internet connection.

1.8. INVESTORS GRIEVANCES

Over the last few years, the capital markets in India have seen unprecedented growth in terms of turnover, volumes of trades, market capitalization, products, issuers, technology as well market intermediaries. The number of investors participating in the market has also soared.
Advancement in information technology in particular is making it possible to set up market facilities in the form of trading systems, at relatively low cost. Even though the investor’s complaint has been reduced considerably, still there are large numbers of unsettled grievances.

According to the information reported in the Handbook of statistics on the Indian securities market 2011 Securities & Exchange Board of India had been received about 276,3565 compliant from investors during the period 1991-92 to 2010-11. This statistic is about the complaint reported by the investors in fact the real number could be more than 3 to 4 times of dissatisfactions reported.

**Table 1.8. Investors Grievances**

<table>
<thead>
<tr>
<th>Year</th>
<th>Grievances Received</th>
<th>Cumulative Grievances</th>
<th>Grievances Redressed</th>
<th>Cumulative Redressed</th>
<th>Pending Grievances</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 91</td>
<td>18794</td>
<td>18794</td>
<td>4061</td>
<td>4061</td>
<td>14733</td>
</tr>
<tr>
<td>1991-92</td>
<td>110317</td>
<td>129111</td>
<td>22946</td>
<td>27007</td>
<td>102104</td>
</tr>
<tr>
<td>1992-93</td>
<td>351837</td>
<td>480948</td>
<td>66,308</td>
<td>93315</td>
<td>387633</td>
</tr>
<tr>
<td>1993-94</td>
<td>197029</td>
<td>677977</td>
<td>339517</td>
<td>432832</td>
<td>245145</td>
</tr>
<tr>
<td>1994-95</td>
<td>516080</td>
<td>1194057</td>
<td>351842</td>
<td>784674</td>
<td>409383</td>
</tr>
<tr>
<td>1995-96</td>
<td>376478</td>
<td>1570535</td>
<td>315652</td>
<td>1100326</td>
<td>470209</td>
</tr>
<tr>
<td>1996-97</td>
<td>217394</td>
<td>1787929</td>
<td>431865</td>
<td>1532191</td>
<td>255738</td>
</tr>
<tr>
<td>1997-98</td>
<td>159670</td>
<td>1947599</td>
<td>222842</td>
<td>1755033</td>
<td>192566</td>
</tr>
<tr>
<td>1998-99</td>
<td>99132</td>
<td>2046731</td>
<td>127227</td>
<td>1882260</td>
<td>164471</td>
</tr>
<tr>
<td>1999-00</td>
<td>98580</td>
<td>2145311</td>
<td>146242</td>
<td>2028502</td>
<td>116809</td>
</tr>
<tr>
<td>2000-01</td>
<td>96913</td>
<td>2242224</td>
<td>85583</td>
<td>2114085</td>
<td>128139</td>
</tr>
<tr>
<td>2001-02</td>
<td>81600</td>
<td>2323824</td>
<td>70328</td>
<td>2184413</td>
<td>139411</td>
</tr>
<tr>
<td>2002-03</td>
<td>37434</td>
<td>2361258</td>
<td>38972</td>
<td>2223385</td>
<td>137873</td>
</tr>
</tbody>
</table>
Table 1.8. (Continued)

<p>| | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2003-04</td>
<td>80422</td>
<td>2441680</td>
<td>64262</td>
<td>2287647</td>
<td>154033</td>
</tr>
<tr>
<td>2004-05</td>
<td>53409</td>
<td>2495089</td>
<td>53282</td>
<td>2340929</td>
<td>154160</td>
</tr>
<tr>
<td>2005-06</td>
<td>40485</td>
<td>2535574</td>
<td>37067</td>
<td>2377996</td>
<td>157578</td>
</tr>
<tr>
<td>2006-07</td>
<td>26473</td>
<td>2562047</td>
<td>17899</td>
<td>2395895</td>
<td>166152</td>
</tr>
<tr>
<td>2007-08</td>
<td>54933</td>
<td>2616980</td>
<td>31676</td>
<td>2427571</td>
<td>189409</td>
</tr>
<tr>
<td>2008-09</td>
<td>57580</td>
<td>2674560</td>
<td>75989</td>
<td>2503560</td>
<td>171000</td>
</tr>
<tr>
<td>2009-10</td>
<td>32335</td>
<td>2706895</td>
<td>42742</td>
<td>2546302</td>
<td>160593</td>
</tr>
<tr>
<td>2010-11</td>
<td>56670</td>
<td>2763565</td>
<td>66552</td>
<td>2612854</td>
<td>150711</td>
</tr>
</tbody>
</table>

Source: SEBI Annual Report

SEBI received 56670 complaints for the financial year 2010-11 and resolved 66552 complaints as compared to 32335 grievances received and 42,742 grievances resolved in the year 2009-10. As on March 31 2011, there were 150711 complaints pending for resolution as compared to 160593 unresolved grievances as on March 31, 2010. This includes 122058 grievances where appropriate regulatory actions have been initiated. 18,602
Figure - 1.8. Investors Grievances
1.9. STATEMENT OF PROBLEM

The Indian stock market still faces many challenges if it is to promote more efficient allocation and mobilization of capital in the economy. The market infrastructure has to be improved as it hinders the efficient flow of information and effective corporate governance. The court system and legal mechanism should be enhanced to better protect small shareholders’ rights and their capacity to monitor the corporate activities.

The trading system has to be made more transparent. Market information is a crucial public good that should be disclosed or made available to all participants to achieve market efficiency. India may need further integration of the national capital market through consolidation of stock exchanges. The trend all over the world is to consolidate and merge the existing stock exchanges. There is a pressing need to develop a uniform settlement cycle and common clearing system that will bring to end unnecessary speculation based on arbitrage opportunities.

The Stock Exchange is an organized secondary market where securities like shares, debentures of public companies government securities and bonds issued by municipalities, public corporations, utility undertakings, port trusts and such other local authorities are purchased and sold. Since, buying and selling of different types of securities take place in stock exchanges, the prices of particular securities reflect their relative demand and supply.

The prices of individual security indicate the financial health of individual companies. The share prices over a period are indicated as an index of the financial status of an organization. Thus, investors can take decisions about the suitability of particular securities for investment in terms of safety, profitability and risk. Besides, he can change his decision when necessary, as
liquidity of investment is provided by easy transferability of securities through the stock exchanges.

There are thousands of small investors who pick up stocks in the public issue boom or around that period, but who are today stuck in various parts of the country, with no exit route for their stocks, even as the myth of huge trading volumes continues in these two exchanges of the NSE and the BSE concentrated around just a few shares. It is here that the regional stock exchanges still have an important role to play. Their volumes have admittedly dried up, thanks to the onslaught from the two biggies. But if these regional stock exchanges come together, they can create a market for these huge numbers of illiquid stocks that the investors are stuck with.

No matter how much the Indian market develops in terms of automation, rolling settlements and the derivative products, the small investor will not return unless there is true depth in trading. The SEBI will have to ensure that the regional bourses do not die as a result of the emergence of the NSE and the BSE, but are given the right ambience to chart out a survival strategy for them. Trading technology is getting more complex and investors are tending to gravitate to the larger exchanges as a result of better rates and higher liquidity.

The share brokers are trying to identify the behaviour of the customers, but in most of the critical occasions, consumer behaviour is unpredictable. In many cases, customers behave in an irrational and greedy manner. The customers are vulnerable during the periods of volatile economic, political and international environment. As the service providers are secure without any financial involvement from either side, they may trend to be careless about their customers and their hard earned money which may disappear quickly, leaving many of them bankrupt. The integration of the
customers and the brokers would be mutually beneficial not only for themselves but also for the share market.

Against this background, the present research seeks to examine, “A Study on Financial Services Provided by the Share Brokers with Special Reference to Coimbatore District”.

1.10. OBJECTIVES OF THE STUDY

1. To examine the socio-economic characteristics of the share brokers and investors.
2. To study the service quality dimensions provided by the share brokers and the perception of investors on the service quality dimensions.
3. To analyze the satisfaction of services provided by share brokers and the services received by the investors.
4. To examine the relationship between the investment behaviour and the influence of investment behaviour on monthly transactions of investors.
5. To study the strengths, weaknesses, opportunities and threats so as to identify the strategies for better services provided by the share brokers.
6. To examine the service gap between the investors and the share brokers.
1.11. HYPOTHESES

1. There is no significant difference among the socio-economic characteristics of the share brokers and the investors.

2. There is no significant difference among the service quality dimensions provided by the share brokers and the perception of the investors on service quality dimensions.

3. There is no significant difference among the satisfaction of services provided by the share brokers and the services received by the investors.

4. There is no significant difference between service rating and recommendation by the investors.

5. There is no significant relationship between investment behaviour of the investors.

6. There is no significant influence of investment behaviour on the monthly transactions of the investors.

7. There is no significant customer relationship features discriminate the association of the investors with the share brokers.

8. There is no significant difference between strength, weakness, opportunities and threats for services provided by the share brokers.

1.12. SIGNIFICANCE AND THE NEED FOR THE STUDY

SIGNIFICANCE

The socio-economic characteristics of share brokers and investors would assist in understanding the socio-economic environments which would critically influence the investment decisions and the share market environment. The service quality dimensions provided by share brokers and the perception of investors on service quality dimensions would be helpful to identify the key service parameters for formulating the marketing strategies
and also for decision making process. The analysis on the satisfaction of services provided by share brokers and the services received by investors helps to understand the stake holder’s behaviour and customer relationships.

The relationship between the investment behaviour and influence of investment behaviour on monthly transactions of investors would be useful to assess the major investment behaviour, for increasing and improving the quality transactions and investment pattern in the share market. Besides, the SWOT analysis, i.e. the strength, weakness, opportunities and threats analysis are highly useful to identify the strategies for better services provided by the share brokers and also for formulation of investment and marketing strategies. The knowledge in service gap between share brokers and investors will help the share brokers to formulate service strategies.

THE NEED

The research “A Study on Financial Services provided by the Share Brokers” has been carried out in Coimbatore District. The present study focuses on four important components such as Services Quality, investor’s satisfaction, CRM and Services GAP. It has been found a number of researches had been carried out in these areas; to quote a few:

respectively. Chuang (2010) had focused his research on service quality measurement.

There are more number of researches focused on service quality and application in various industries; but unfortunately there is no study focused on share broker’s service quality and its implications.

Parasuraman *et. al.*, (1985) introduced service gap model, Lee and Marchant (2010) studied the service quality gap in Singapore share brokers. It is disappointing to note that not much research has been conducted to find out the services gap among the share brokers and investors in India.

Customer satisfaction is also an important and well addressed research area; Oliver (1993), Anderson et. al. (1994), Spreng and Mackoy (1996), Bansal and Taylor (1999), Bateson and Hoffman (1999), Yang (2001), Tam and Wong (2001), and Cox (2002) have focused their research on customer satisfaction. Helm & Sabrina (2007) and Gyu-yeol et. al. (2009) studied the investment satisfaction of investors. But not many studies are found on investors’ satisfaction on share brokers.

Investment strategy formulation and implementation are the other well researched areas where, De Bondt (1998), Alexander (2005) and many others studied momentum stock investment strategies. Busse and Green (2001) focused on day trading strategies, Ajay Kumar (2004) focused on investors preference on share brokers, Nidhi Walia (2004), Ravinder Kumar & Nidhi Walia (2007) studied online trading strategies, Bushee and Raedy (2005), Jayanta Kumar Seal (2007) had focused their study on trading strategies, Pradhan and Upadhyay (2009) has analysed the investment strategies. Though the investment strategies were well researched, there exist
only a few studies to focus on the strategies formulation for share brokers to attract and retain the new investors.


Even though CRM and its implementation are very important for all the industries, researches on relationship management for share brokers have been found to be insignificant so far.

It is apparent that there is no study in India focusing the share broker’s role on investor satisfaction, service quality, relationship management, and services gap between the share broker’s perception and the investors’ expectations. The present research, “A Study on Financial Services provided by the Share Brokers” is very unique of its kind in content and area of research.

1.13. ORGANIZATION OF THESIS

The first chapter introduces the financial industry, and elaborates the regulatory norms in the financial industry, products and players. The statement of problem and significance of the study have been discussed in this chapter. The objectives of the study and hypotheses are also enumerated in this chapter
The second chapter deals with the review of literature related to the study. The reviews have been discussed under Service Quality Dimensions, Customers Satisfaction, Strategies, and Relationship Management.

The third chapter presents the research methodology used for the research and the various tools used for data analysis.

The fourth chapter is the analysis of various services and strategies of the share brokers. This chapter discusses the share brokers’ socio economic information, their association with investors, service quality dimensions, discriminant analysis for investing based on the customer relationships and the SWOT analysis. The investors’ satisfaction with the share brokers and their relationship with the share brokers are also discussed elaborately in this chapter.

The fifth chapter deals with the investment behaviour and analysis the satisfaction of share market investors. The socio economic characteristics of the investors, the investors’ perception on service qualities, investors’ satisfaction on service provided by share brokers and the discriminant analysis for customer relationship based on association with share broker are the key elements discussed in this chapter.

The sixth chapter presents a critical analysis on the service gap between the investors and the share brokers. The services gap in service quality, services satisfaction and customer relationship between the share brokers and the investors are presented in this chapter.

The Seventh chapter summarises the various findings about share brokers and investors. The conclusion is presented along with
recommendations. The scope for future research has also been discussed in this chapter.

1.14. PROPOSED RESEARCH MODEL

![Proposed Research Model Diagram]

Figure-1.14. Proposed Research Model