2.0 INTRODUCTION:

The aim of this chapter is to review concerned literature. This chapter is divided into three sections. Section one deals with literature in the global scenario, section two deals with literature in the Indian context whereas section three identifies certain gaps in the earlier literature and suggests the need for the present study.

2.1 LITERATURE IN THE GLOBAL SCENARIO:

Globally, there are increased evidences to suggest that investor confidence has assumed an important role in the economic development of a country. In this context, The Economist (1998) indicated that a lot of issues need to be addressed to make the capital markets safer. Transparency, strengthening the financial system and managing crisis are the issues which cannot be quickly fixed. All of these require a long term strategy of promoting growth and
regulating the market place. Companies with no earning record and with inexperienced directors got listed on stock exchanges. Their only objective was profit making out of inflated market price. The net result is that investors, especially the small ones, lost confidence in the market.

Lee Hsien Loong (2000) emphasized upon the importance of rebuilding investor confidence for prosperity of ASEAN countries. He indicated that for investor confidence, rebuilding of sound fundamentals, dealing with capital account risks, economic co-operation amongst ASEAN countries, corporate restructuring, banking sector reforms and improvement of social and political conditions is important.

Joseph Oliver (2002) studied the steps taken by the Canadian Government to develop healthy capital market, enhance investors confidence, and the importance of regulatory and intermediaries in capital market in ensuring good corporate governance. He suggested that half of all Canadians have investments in equities and their confidence is essential to healthy and dynamic capital market. Deep bear markets, corporate scandals, insider trading, high levels of
executive compensation and inaccuracy of published financial statements are cited as reasons for lack of investor confidence in Canadian capital markets. He was of the opinion that regulators, accounting professionals, analysts and broking firms, public companies, shareholders and Government must contribute to ensure good governance and reduce corporate failures.

McCall (2002) in his testimony before the Committee on Financial Services United States House Representatives, observed that the integrity of the financial markets and economic well being of the country depend on corporate accountability and investor confidence. Bumgarner and Pime (2000) have studied the capital flows to and from Hong Kong in the years prior to its reversion to Chinese sovereignty and during the transition. They have indicated that Government policies have an impact on investor confidence and capital mobility. Bloomfield, Libby and Nelson (2002) have indicated that less informed investors are over confident in investments.

The World Federation of Exchanges conducted a survey in 2002 on trading practices at major stock exchanges through
renowned Professor Maureen O'Hara of Cornell University. The report was released in 2003. She used the questionnaire method for studying the same.

The broad findings of the study were-

- About 86% of exchanges have platforms that include stock watch or real time error alerts. About 88% of exchanges have backup systems in place that are fully redundant.

- 12% of the exchanges have the system that gives direct access for order routing and straight through processing is common place (55%).

- 49% of the exchanges offer automatic execution of small orders and 71% offer opportunities for price improvement and order processing times are typically less than a second.

- Global markets have become more and more transparent. The majority of exchanges disclose substantial market information and disseminates them through a variety of ways: 90% through feed data, 74% through internet, 69% through trading system, 36% through special information system and 7% through satellite. 57%
display the depths of all prices, another 26% display depth for specific price levels and 17% allow indicative quotes to be disclosed.

- 76% of the exchanges operate within a self-regulatory framework. As far as how regulatory functions are handled, in 40% of exchanges are handled internally, 14% by a separate non-government entity, 21% are by Government regulator and 38% are handled jointly with a regulatory authority.

Brian J. Porter (2005) pointed out that a market that is unregulated could fail to properly protect investors—prompting them to take their capital elsewhere. But a market that is over-regulated could easily stifle growth, innovation and efficiencies. What is required is "balanced regulation"—not too loose and not too rigid.

2.2 LITERATURE IN THE INDIAN CONTEXT:

The first survey about Indian Capital Market was undertaken by Society for Capital Market Research and Development, Delhi and was sponsored by the Securities and Exchange Board of India. The survey involved interviewing nearly 6000
households spread over more than 100 cities and towns all over India.

The major findings were:

a. Shareholders became a middle class phenomenon. Earlier it was largely confined to only the wealthy classes.

b. Two-thirds of shareholders had entered the share market for the first time after 1980 only. Shareholders among the lower middle class and younger people had a much higher proportion (75-80 percent) of the post-1980s entrants.

c. Only about 2.5 percent of Indian households owned shares then. Among urban households, about 10 percent owned shares.

d. About one-fourth of shareowners had shares of only 1 or 2 companies and slightly above half of them had no more than 5 companies in their share portfolios.

e. Bulk (nearly three-fourth) of the shareowners were long term investors.
f. Nearly four-fifth of Indian shareholders were dissatisfied with the working of the then present mechanism for redressing their grievances.

g. Over 50 percent of shareowners had specific complaints against stockbrokers and over 60 percent has specific complaints against companies.

In the Indian context, Gupta (1996) has indicated that from the angle of investor protection, the regulation of the new issue market is important for several reasons. The number of small investors in new issue market is massive. Most of new investors make their first entry into equity investments via the new issue market. So retaining confidence and protecting investors from the vagaries of primary markets is important.

Gokaran (2000) conducted an All India survey using questionnaire method. His study is based on primary data. He has studied the financing patterns of the corporate growth in the country and his study indicated that equity markets
suffer serious deficiencies as a mechanism for raising capital\textsuperscript{15}.

Murali (2002) has indicated that New Issues Market (NIM) focuses on decreasing information asymmetry, easy accessibility of capital by large sections of medium and small enterprises, national level participation in promoting efficient investments, and increasing a culture of investments in productive sector\textsuperscript{16}. In order that these goals are achieved, a substantial level of improvement in the regulatory standards in India at both voluntary and enforcement levels is warranted. The most crucial steps to achieve these goals would be to develop measures to strengthen the New Issues Market.

In 1999/2000, SEBI has also undertaken a survey to understand the nature of investment, concept of investment and the psychology of the small investors\textsuperscript{17}. This survey has been conducted along-with NCAER (National Council of Applied Economic Research). The goal of this survey was to estimate the number of households investing in equity, bonds/debentures and mutual funds and their economic and demographic profile. In addition, the future plans of
investment in equity, bonds/debentures as well as mutual funds by the type of investor were to be studied. The study also provided estimates on non-investor households, their economic and demographic profile and their plan to invest in the equity market.

The major findings of the survey were:

- Nearly 8% of all Indian households representing 19 million individuals had directly invested in equity shares or debentures or both as at the end of year 1998-99.
- An estimated 9% of all households have invested in units of mutual funds.
- Investor households increased at a compounded rate of 22%. Interestingly, the rural households increased at a compounded growth rate of 30% compared to urban investor households which increased at a compounded growth rate of 22%.
- Bank deposits were considered to be very safe i.e. least risky followed by gold. Debentures and equity were perceived equal in terms of risk.
Despite the expansion of the securities market, only a very small percentage of household savings were being channelised into the securities market.

Of the 12.1 million equity investor households, 84 per cent had invested in equity shares through the primary market and 63 per cent had bought equity shares in the secondary market.

Ajay Shah (1999) studied the institutional change in the Indian Capital Market and identified eleven problems in the market, as of 2002. These have been discussed at a later stage in this study.

Another survey was conducted by Society for Capital Market Research & Development in 2002 on why ordinary Investors remain Disenchanted. Following were the findings of the survey.

- This study showed that the single most worry as identified by the data collected from household heads was "fraudulent company managements". Income-class wise average percentage of respondents worried on this account varied above 20 per cent in every income class. It varied only between 11.1 percent and 20 per
cent in the 2001 survey. The worsening of this problem compared to 2001 meant that the regulatory measures against corporate malfeasance and mismanagement were absolutely inadequate. A need was identified for more drastic reform of the corporate governance system from the viewpoint of its accountability to the "minority" shareholders. This also meant that SEBI prescribed corporate Governance code had absolutely no effect.

- In the opinion of a great majority of ordinary investors, the regulation of the Indian Stock Market was largely ineffective in protecting investors and ensuring fair dealing and orderly markets. This was the dominant perception of household investors both in 2001 and 2002 is high. As high as about 70% of the sample household heads across all income and age classes said "No" when a question was asked "Are Govt./SEBI measures for protecting investors in companies adequate for reviving investors' confidence?"

- A large majority, around 64% or a little below two-thirds of household investors were found to be long-
term oriented investors, who ordinarily buy shares with the intention of holding them for "some years" only.

- Only a relatively small fraction of Indian household investors were frequent traders or speculators. 75% of sample households owned shares, only 29% of households were found to have both bought and sold during the 12 months preceding the survey.

- A majority of the middle class shareholders continued to hold paper certificates simply because they found the depository system not cost-effective from the long-term shareholders point of view. The whole depository system in India seemed to have been designed keeping in view the needs of frequent traders and speculators rather than the needs of long-term investors who trade only once a while.

A research study sponsored by the Department of Company Affairs, Ministry of Finance was conducted during the year 2002/2003. This survey was conducted with the help of the VOICE (Voluntary Organisation in the Interest of Consumer Education) Research Team and was sponsored by Investor
Education and Protection Fund, Department of Company Affairs, Ministry of Finance (Government of India). The report was prepared by Professor Sri Ram Khanna with Paramjeet Singh and Vanita Tripathi. This was a unique attempt made by a NGO to understand the problem of small investors and status of small investors' protection system in India. More than one-third respondents of this survey had monthly income levels between Rs 10,000-Rs 15,000 followed by 21.8 percent respondents having income levels between Rs 15,000-Rs 20,000.

- Maximum numbers of respondents were found holding investment in equity market followed by fixed deposits and other investments in capital market. Bank Fixed Deposits were perceived to be the safest and NBFC as the most risky ones.

- One-fifth of the respondents contacted during the survey said that they had been deceived or cheated in the capital market. The main cause for loss of money was vanishing companies and manipulation by companies, directors and brokers. These respondents had lost money in the range of Rs 3000 to Rs 3,00,000. However,
only 30 percent of those been cheated sought redressal from any agency. This was because of lack of awareness about agencies, high cost of redressal and lack of faith in agencies meant for investment protection.

- More than 42 percent of respondents were having no demat accounts. The main reason for not having one was cited as "not required". More than 43 percent of respondents having demat accounts had raised concerns about high demat charges.

- As far as dependence on brokers is concerned, survey showed that over 56 percent of respondents had dealt with at least one broker within the last three years. Cheating, default and wrong information among others were cited as major problems faced by the respondents.

- The survey was quite clear that existing investor protection agencies like SEBI, RBI and Investor Guidance Cell were perceived as time taking, expensive and unfriendly. In order to meet investors expectations, working of those agencies needed to be reviewed with respect to grievance handling methods
and procedures so that they became more investor friendly, trustworthy and efficient.

Dr K. Santi Swarup conducted a survey in December 2003 and published a paper on measures for improving common investor confidence in Indian Primary Market. This study is based on questionnaires administered to investors in ten cities of India.

- Issue price, information availability, market price after listing, liquidity after listing, secondary market situation, lead manager’s image and regulatory environment are the factors which affect primary market situation. These were studied and ranked.
- The survey revealed that 79.3 percent of the respondents did personal analysis of the offer documents before investing and 59.7 percent indicated that they may sell the shares after allotment.
- Current market price was perceived as a better investment indicator for investors than analysts’ recommendations.
- Issue price emerged as one of the most important factors affecting primary market issues with 80.7 per
72.2 percent of respondents gave first four ranks to information availability as a factor affecting primary market situation. In the age category of above 60, only 56.25 percent considered information availability as important factor based on first four ranks. In the occupation categories, 82 percent of professionals considered information availability important as compared to 62 percent of businesspersons consider it important.

66 percent of respondents gave market price after listing as an important factor affecting primary market condition.

The issue price ranks first with the lowest median value (highest preference). Information availability, market price after listing occupies the second and third rank respectively. Liquidity, secondary market situation and lead managers' image occupy 4th, 5th and 6th position respectively. 7th rank was accorded to
regulatory environment as a factor affecting primary market situation based on the lowest preference.

A subsequent survey was carried out by Dr. L. C. Gupta, Naveen Jain, Utpal Chaudhary and Sachit Gupta (2004), an interim report of which was submitted on October 1, 2004. This study was sponsored by the Department (now Ministry) of Company Affairs under the Investor Education and Protection Fund (IEPF). The purpose of this study was to deepen understanding about investors' problems and needs. The sample size was 5908 household heads spread over 90 cities/towns across 24 states/union territories. This study was based on two partially overlapping questionnaires, one which was filled through personal interview and other being a supplementary questionnaire sent through post along-with a business reply envelope.

The major findings of the study were:

- About 30% of the respondents mentioned too much price volatility as the top-most worry facing the Indian Capital Market.
• The second most worry was named as too much price manipulation. One out of every five investors named this as a big worry.

• The third most important worry was named as corporate mismanagement/fraud.

• These factors have been persistently the top three worries in all previous surveys conducted by SCMRD earlier.

• However, more than half of the respondents were positive about the efforts taken for improving corporate governance.

• 38% of the respondents were investors in delisted companies. Also, once companies are delisted, they get away from the purview of SEBI.

• Indian investors do not look very positively on mutual fund equity schemes as compared to owning equity directly.

• Data compiled from AMBI shows that the mutual fund industry has shifted focus from small investors to high net worth individuals (HNIs) and corporates.
• Typical extent of share portfolio diversification for small investors lies in a band of 3 to 10 companies shares.
• Middle and higher middle class investors are a conservative lot and do not do much speculation.
• Retail investors have now become less gullible and look at all IPOs with a magnifying glass.
• Many of the small investors have remained outside the share depository system.

In his speech on August 13, 2003 during the seminar “Indian Securities Market: New Benchmarks”, Mr. G N Bajpai indicated that he sees disintermediation in the near future. Investors would be able to deal directly with the stock exchanges and brokers would be redundant. And with the speed at which integration of the markets in the world is happening, there would be only one or two clearing houses in the entire world. Tomorrow’s investors would not be perceived as investors but as buyers of financial solutions. Dr. Kirit Somaiya in his doctoral thesis, “Scientific Management of Small Investors Protection in the new millennium with reference to India: Challenges and
Opportunities (1991-2011) studied the existing regulatory framework of the capital market. He interviewed twenty-six experts and authorities of the finance and capital market. The future of capital market, the role of small investors and a roadmap for achieving better investor protection by 2020 has been studied.

During 2002, two new committees were constituted on corporate governance in India, viz (1) Naresh Chandra Committee and (2) N. R. Narayana Murthy Committee by SEBI. Both these two committees relied on the system of "independent directors" in order to secure good corporate governance in Indian listed companies. This is a very prevalent concept in the U.S. and the U.K., where most of the large companies do not have 'controlling blocks', but it may not work equally well in India because our corporate ownership structure is very different.

The Naresh Chandra committee recommended that at-least 50 per cent of the Board of listed company should consist of "independent directors". The committee expressed the hope that independent directors will be able to speak, stand up and be counted. This ignores the fact that these independent
directors are elected to the Board by the grace of the controlling group and owes a natural allegiance to the group. If the management perceives them as a 'nuisance', they are likely to be dropped. However, these independent directors would have an interest in continuing as director as long as possible because of the perks and prestige attached to the position of corporate director.

The Murthy committee attempted to find a solution to this problem by making an innovative recommendation that the companies must immediately inform SEBI and stock exchanges along with a statement about the circumstances leading to the dismissal. The committee also suggested that in case of disagreement, this independent director should also have an opportunity to be heard during the AGM.

In countries like India, where controlling blocks are common, there needs to be strengthening of laws for protection of minority interest, since all outside shareholders become minority interests in a company where promoters have majority of shares in their hands. Some controlling blocks are large enough to get even special resolutions passed at general meetings. In India, protection
of these minority interests is weak and this is an important reason why ordinary investors may not at all feel enthused by these reports of corporate governance.

Sucheta Dalal, the famous columnist has also written extensively on the capital market and investor protection. She wrote on the 6th June, 2003 about her speech made at the CII (Confederation of Indian Industries) National Conference on April 9, 200324. She pointed out that the best of corporate groups have short-changed investors—especially during mergers and takeovers. The largest private sector companies have brazenly indulged in price manipulation and sometimes insider trading. Leading companies have found obnoxious loopholes or used the opaqueness of Sec. 391 of the Companies Act to leave retail investors in the cold.

In an article named "10 years of financial scams", she states that despite all the developmental efforts, the capital market remains seriously flawed because three key ingredients are still missing 25. They are adequate supervision, strict accountability and appropriate punishment. Retail investors have been the biggest losers and the effect of this disenchantment is visible in the slow
growth of India's investor population. China has over 25 million investors, while India, with all its rapid development and its 130-year old stock exchange culture has only 19 million investors.

In an article “The Judiciary will have to help the investors cause” she details out the reasons for problems faced by investors. She states that the basic problem is that investors are not organized and cannot put up a common front. A bigger problem is that the popular corporate view is that investors require no protection; that they are all greedy operators who rush to buy when prices are at the highest and whine when they collapse. In order to educate these small investors, she argues that many more investor associations need to work in the country and they are not recognized by SEBI because they need seed money to commence operations, establish a record of accomplishments—it is thus a catch 22 situation! Litigation is also slow and an expensive process and even if the court has ruled in favour of the investors, the relief and costs granted to them are so niggardly that they only act as a deterrent to investor litigation.
2.3 THE GAP:

All the above studies conducted by various research institutes, agencies and researchers have tried to analyze why investors are disenchanted, how they make decisions, what needs to be done for revival of investor confidence. But these have not covered what roles the SEBI, BSE, NSE have played in the capital market to really protect the rights and interest of the small investor. Are the safeguards and measures taken by SEBI to protect these investors perceived as enough? Would some investor who has already interacted with SEBI, like to interact with them once again if there is a problem once more? These are some questions this study attempts to find answers to.

All the investments in the capital market are risky and the amount of risk involved as well as the methods of reducing risk should be known first. This can be understood in terms of legal provisions, agencies for redressal of grievances and available avenues for investor protection. The role of Investor Grievances Cells in stock exchanges, Company Law Board should be made clear to the investors for protection against malpractices of brokers and companies. Some of the
uncontrollable factors and unavoidable risks in investment should be understood by the investors beforehand and before making investments. Very few studies have been carried out on this aspect. Moreover, SEBI's role in protecting investors and regulating the various intermediaries and other entities have not been studied well. So we have taken up this study.

Another gap in the above studies is about investor education which is of utmost importance in protecting the interest of investors. The basic objective of investor education is to not only help investors in protecting but making them aware of their rights and responsibilities. It should be comprehensive enough; covering all the components of primary as well as secondary markets etc. More important is investor should know the technique of choosing a broker, put an order and get it executed. they should be informed of legal basis of the markets, institutional framework, settlement and clearing process of the stock market. There are plenty of booklets published by SEBI, BSE, NSE and investors associations for guiding investors. But these
have not been studied in a comprehensive manner and hence this study has been taken up.

In conclusion, it can be seen from this chapter that lot has been written, surveyed and examined in the Indian Capital Market. However, there remain some gaps which this study aims to fill in.