CHAPTER 1

INTRODUCTION
Chapter I

Introduction

Reforms in Indian Economy

Recall the face of the poorest and the weakest man whom you may have seen and ask yourself if the step you contemplate is going to be of any use to him. Will he gain any thing out of it? Will it restore him to control over his own life and destiny?

-M. K. Gandhi

Agriculture & other activities of the economy were the two limbs of Indian economy which was characterised by central planning for development and minimum of foreign participation. The economic reason for the desirability of reforms is that it raises the long run growth rate of the economy. In the early stages of development planning the government was viewed as the principal actor in the development, exercising strict control over private investment and ensuring a dominant role for the public sector in all important industries. Trade policy tended to be inward oriented focusing on industrial development through import substitution which was encouraged through a tight control over the imports and maintenance of high tariffs. Reforms are means to achieve the ultimate goal of economic development of the country and the well being of its people.

Though the economic reforms in India have started in 1980s, but it has got logically consistent shape only since 1991. The package of economic reforms in India consists of:

1. Deregulation and liberalisation of all markets,
2. Increasing competitiveness in all spheres of economic activities, and

3. Living with in the means or a strong budget constraint on all economic agents.²

The economy was radically transformed by adopting the mantra of LPG (Liberalisation, Privatisation & Globalisation). The year 1991 has showed a significant 'U' turn in the mind set of the law makers of the country. Till then it was the Government which used to determine the development, but for the first time it was the market and not the government which began to determine the development.

The then coalition Government of congress party headed by Sri Narasimha Rao as Prime Minister and Dr. Manmohan Singh as Finance Minister at the helm of affairs, assumed the office of the economy which was in deep crisis characterised by precarious position of balance of payments and weakening of international confidence, double digit inflation, slow economic growth etc. The Government took a series of measures to bring the situation under control. And thus the era of reforms started. Having put on the right track the Indian economy has not seen backwards. The succeeding Governments were compelled to follow the suit and various reforms in different sectors were initiated.

By and large, Indian Financial System by 1991 had become fairly widened, deepened and broadened. After the recommendations of the two Narasimham Committees-1991 and 1998- patterned largely on the guidelines of the Bank of International Settlements, reforms have been carried out in India in the right earnest.
In all its segments, structural reorganization, partial privatization and deregulation have been effected. The resilience of the Indian Financial System is well evidenced by its relative stability during 1997-1998 when several South East and Far East Asian and Latin American countries had experienced severe currency and forex turbulence. The reforms may be architectural reforms or regulatory reforms.

The Financial System

The financial system of any country is as vital to the economy as the land, labour and capital (productive resources) that are used to produce goods and services. The financial system in a modern economy is a collection institutions and markets that interact in order to perform a number of important functions.

![Simple Representation of Financial System]

**Figure No: 1.1 Simple Representation of Financial System**

1. Facilitating the borrowing and lending of funds is the most important fundamental function performed by the financial system in any economy.

2. The financial system in reality is very complex. Financial system performs most of its everyday operations so quickly and smoothly that its importance is not always well readily recognised. Few observers notice how easily a well functioning financial system performs its principal roles: effecting payments, facilitating the investment of accumulated wealth, making funds available to finance viable new projects and providing risk management facilities. In
addition its functioning becomes still more evident and important as the financial system can contribute to the economic growth.\(^4\)

Figure No: 1.2 Detailed Representation of Financial System\(^5\)
Financial Market

Financial markets are the centers or arrangements that provide facilities for buying and selling of financial claims and services. The corporations, financial institutions, individuals and governments trade in financial products in these markets either directly or through brokers and dealers on organised exchangers or off-exchanges. The participants on the demand and supply sides of these markets are financial institutions, agents, brokers, dealers, borrowers, lenders, savers and others, who are interlinked by the laws, contacts, covenants and communication networks.\(^6\)

The functions imputed to the Financial Market are in short the following:

1. The banks are supposed to provide the basic payment facilities such as bank notes and demand deposits.

2. The financial markets are supposed to absorb all income not consumed by households or spent in the product market (savings) and channel them to real investments. In this way the financial market provides the opportunity of selling financial claims to raise the necessary funds for the investment projects & is expected to mobilise all national savings by transforming the risk bearing liabilities of deficit units into safer assets for surplus units and converting long maturity liabilities into more liquid assets.\(^7\)

The financial market is classified differently by various people. The important classifications are:
1. On the basis of maturity of claims.

On this basis the financial market is broadly divided into money market and capital market. Money market primarily deals with the financial claims of short term, which have a maturity of less than one year, whereas the capital market deals with the long term financial claims.

2. On the basis of the status of the claims

On this basis the market is divided as primary market and secondary market. The primary market deals with the issue of new claims, whereas the secondary market deals with existing claims of the investors.

The financial market facilitate price discovery, provide liquidity to the financial assets and reduce the costs of transacting.8

The main organised financial markets in India are:

- The credit market dominated by the commercial banks
- The money market with call/ money segment forming its sizeable portion
- Equity and term lending markets consisting of primary, secondary and term lending segments
- Corporate debt market comprising of PSU bonds & corporate debentures
- Gilt edged market for government securities
- Housing finance market
- Hire purchase and leasing market where the non banking financial companies predominate
- Insurance markets
- Foreign exchange markets
Besides the above, there is an informal finance market, on which the flow of information is limited and is not easily ascertainable.

In India, there are a plethora of organisations and labyrinth of rules for monitoring the financial sector. The Government, Departments of Economic affairs, Company affairs and Consumer affairs, Reserve Bank of India, Securities and Exchange Board of India, Forward Markets Commission etc. all have a role to be played in monitoring, controlling and regulating the financial sector. The RBI regulates and supervises the banking, financial, debt currency and foreign exchange markets, SEBI the new issue and stock markets, and FMC the commodity derivatives markets.

Money market

Money market is the centre for dealings, mainly of short term character, in monetary assets. It meets the short term requirements of the borrowers and provides liquidity to the lenders. It is the place where short term surplus investible funds at the disposal of the financial and other institutions and individuals are bid by borrowers, other comprising institutions and individuals and also by the government.

Most major economic entities, whether, corporate bodies, government bodies or financial institutions face, recurring problems of liquidity management. It is the money market which helps them in tackling this problem. If the problem is that of cash outflow in excess of cash receipts, the deficit is met by borrowing from the money market. If the problem is that of a temporary cash inflow that the entity does not want to commit on the long-term basis, the surplus can be deployed in the money market.
The money market is thus the market of overnight to short term financial assets that were close substitutes of money. This is, however not to say that clear demarcation exist between the short term money market and the long-term capital market. In fact the array of instruments available provides a continuum between the two markets. Thus it is the money market that meets short time requirements of borrowers and provides profitable avenues to lenders.

The money market can be divided into inner and outer sphere, the inner constituting a nucleus of specialized institutions- the Reserve Bank, commercial banks, non-banking finance companies, discount houses, acceptance houses, Co operative banks and financial institutions and outer extending beyond the center, including the government and the entire system of trade and credit.

The reserve bank, occupies a strategic position in the money market. It is the key constituent, the residual source of supply of funds. The money market can obtain funds from the reserve bank in two ways, either by borrowing or by sale of securities. The reserve bank comes into contact with the financial system as a whole and by varying the liquidity in the market by open market operations and by access to the accommodation if it influences the cost and availability of funds.

Money Markets in India

The short term money market in India consists of market segments such as Inter-bank call and short notice money and term money, treasury bills and Gilt edged securities, bonds, units etc.
The most active segment of the money market has been the call money market where the imbalances, in the fund position, the mostly of the banks are evened out. Unlike the capital market that has seen considerable innovation and change during the last decade, the Indian money market until about some years ago was heavily regulated both in terms of participants and interest rates. There was also a paucity of money market instruments. Prior to the year 1987, the Indian money market was a restricted market with a narrow base and a limited number of participants. The participation in the market was restricted to banks and six all India financial institutions and the entry in the market was tightly regulated. Even amongst the limited participants, there was a considerable amount of lopsidedness with a few predominant lenders and the large number of borrowers and there is absence of participants who make for an active market by alternating between lending and borrowing.9

The money market rates were controlled either by the reserve bank of India directly or by a voluntary agreement between the participants to the intermediation of the Indian banks association (IBA).

The Government of India setup a committee under the chairmanship of Mr. Vaughal. The committee submitted its report in 1987. Some of the major recommendations of the committee are as follows:

1. Increase the number of participants
2. Develop new instruments
3. Move to market determined rates
4. Develop an active secondary market10
The money market instruments that are currently available in the Indian money market are

- Call money
- Government securities
- Treasury bills
- Bills rediscounting
- Commercial paper
- Certificates of deposit
- Participation certificates
- Forward rate Agreements
- Interest rate swaps

**Capital Market**

The term capital market has been defined to mean a securities market in which stocks and bonds with long term maturities are traded.\(^\text{11}\)

The capital market is a financial market for long-term maturity financial assets – Government bonds, corporate bonds and equity. It is a network of financial institutions that brings together suppliers and users of capital, provides funds to Industries and Governments to meet their long-term capital requirements. Therefore the capital market plays a crucial role in stimulating industrial as well as economic growth and development. An efficient capital market mobilizes the savings and allocates a greater proportion to these investments with the highest prospective rates of returns after giving due allowance for risk. This allocating function is critical in determining the overall growth of the economy. If capital resources are not provided
to those economic areas, especially industries where demand is growing and which are capable of increasing production and productivity the rate of expansion of the economy often suffers.\textsuperscript{12}

As we know it very well the capital market is broadly divided into Primary Market and Secondary Market.

There has been, significant changes, in the usage of the terminology of the Capital Market. The term Securities Market is being used interchangeably to that of the Capital Market. However there is a subtle difference between the Securities Market and the Capital Market. The definition of securities as per the SCRA, 1956 includes shares, bonds, scripts, 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 to interdependent and inseparable segments, the new issue (primary) market and the stock (secondary) market. The primary market provides the channel for creation and sale of new securities, while the secondary market deals in securities previously issued. The securities issued in the primary market are issued by public companies or by government agencies. The resources in this kind of market are mobilized either through the public issue or through private placement. It is a public issue if anybody and everybody can subscribe for it, where as if the issue is made available to a selected group of persons it is termed as private placement.
The two major types of issuers of securities, the corporate entities who issue mainly debt and equity instruments and the government who issues debt securities.

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and returns. Once the new securities are issued in the primary market they are traded in the stock (secondary) market. The secondary market operates through two mediums namely, the over the counter market and the exchange traded market. Over the counter markets are informal markets where trades are negotiated. Most of the trades in the government securities are in the over the counter market. All the spot trades where securities are traded for immediate delivery and payment take place in the over the counter 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. The clearing corporation acts as a counter party and guarantees settlement. Nearly hundred percent of the trades in capital market segment are settled through the Demat form. 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., NSE and the Bombay Stock Exchange (BSE) provides trading in the derivatives.¹³
The following products or instruments are traded in the Indian Stock Market.

a) Corporate Securities i.e. Shares, Debentures, Bonds.

b) Derivatives of Securities and Indices.

c) Mutual Fund Units.

d) Government Securities and Bonds.

e) Interests and Rights in Securities.

The principal Laws that govern the Securities Market in India are


The Indian Capital Market is being regulated by various regulators under different Acts. The important regulators are as under.

1. Department of Economic Affairs, Stock Exchange Division, Ministry of Finance, Govt. of India.

2. Department of Company Affairs.

3. Reserve Bank of India.

4. Securities and Exchange Board of India

Many powers under SCRA are exercised by the Department of Economic Affairs and others are exercised by the Securities and Exchange Board of India. There are certain powers which are exercised concurrently by the Central Government and
Major Reforms Initiated

The Financial Sector Reforms began in India the year 1991, with setting up of the committee on the Financial System. This Committee made many important recommendations for implementation in the Indian Financial System. The reforms in the financial sector can be broadly categorized in to three categories. They are banking sector reforms, capital market reforms and insurance sector reforms.

Banking Sector Reforms

The banking system forms the core of the financial sector of the economy. Through mobilization of resources and their better allocation, commercial banks play an important role in the development of a country. Commercial banks improve the allocation of resources by lending money to the priority sectors of the economy. The Narasimham committee worked out the road map of banking sector reforms. Accordingly the Cash Reserve Ratio has been reduced and the interest rate on deposits with RBI has been raised. The Statutory Liquidity ratio has been brought to 25%. Interest rate structure are liberalized and prime lending rates are left to the concerned banks. New generation banks in the private sector are permitted to operate in India. Selective credit Controls are abolished.\textsuperscript{14}
Capital Market Reforms

In India, we have had a capital market since 19th century. But its role was very limited. This was primarily due to restrictive rules and regulations we had in the sphere of promotion of companies, raising of capital and regulation of secondary market. It is only during the eighties along with the process of liberalisation, that there has been a tremendous growth in the capital market. The capital market was passing through a phase of structural transformation.15

Since 1991, a number of policy decisions came into force for strengthening the prospects and performance of Indian Stock Market. Some major reforms so introduced are discussed hereunder.

1. Repeal of Capital Issues (Control) Act, 1947

A major initiative of liberalisation was the repeal of Capital Issues (Control) Act, 1947 in May 1992. Under it, companies were required to obtain approval from the Controller of Capital Issues for raising funds in the market. With the repeal of the Capital Issues (Control) Act, 1947, all controls relating to raising of funds from the market came to an end. Issuers of capital, however, are required to meet the guidelines of Securities and Exchange Board of India on disclosures and protection of investors.16

2. Establishment of Securities and Exchange Board of India (SEBI)

A major initiative of regulation was establishment of statutory autonomous agency, called, SEBI, to provide reassurance that is safe to undertake transactions in securities. It was formed in the year 1988; however it was given statutory recognition
in the year 1992 by enactment of the Securities and Exchange Board of India Act, 1992. The objective of the Act was

- Protecting the interest of investors in securities.
- Promoting the development of the securities market: and
- Regulating the securities market.

SEBI has been going through a protracted learning phase since its inception. The apparent urgency of immediate short-term problems in the capital markets has often seemed to distract SEBI from the more critical task of formulating and implementing a strategic vision for the development and regulation of the capital markets.\(^{17}\)

Sooner it has put in place several regulations for the corporate entities tapping the capital market and market intermediaries. Over a period of time SEBI has pronounced strict disclosure norms for the primary market, disclosures of financial information through the public media limited review of interim financial reporting, regulation for insider trading, regulation for takeover etc.\(^{18}\)

3. Mutual Funds

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

4. Globalisation and Foreign Institutional Investors (FII)

In view of the globalisation and policy of liberalisation, the Indian Securities Market is getting increasingly integrated with the world market. The Indian companies have been permitted to raise funds from abroad through issue of ADRs, GDRs, Foreign Currency Convertible Bonds (FCCBs). Further the Indian companies have also been permitted to list their securities on foreign Stock Exchanges by sponsoring ADR/GDR issues. The Foreign Institutional investors (FII) were granted permission to participate in the capital market since 1992. The FIIs have shown tremendous interest in Indian capital market and pumped in large amounts of money in acquiring stocks from the capital.

5. Screen Based Trading

A major development initiative was a nationwide on-line fully automated screen based trading system (SBTS), where a member can punch into the computer quantities of securities and the prices at which he/she likes to transact and the transaction is executed as soon as it finds a matching sale or buy order from counterparty. SBTS electronically matches orders on strict price / time priority and hence cut down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It allowed faster incorporation of price sensitive information into prevailing prices and increased the informational efficiency of the markets. It provided real time data on the market to the participants in full. In the
process it improved the depth and liquidity of the market by enabling a large number of participants from different geographical locations to do trading through 10,000+ terminals located in the different parts of the country. The SBTS has transformed the trading platform from hail of exchange to the premises of the broker in the first phase and then shifted to PCs in the residence of the investor and latest to the hand held devices through Wireless Access Protocol (WAP). This made a difference in terms of equal access to investors in a geographically vast country like India.

6. Demutualization

Demutualization of exchanges means segregation of ownership from management. This move was necessitated by the fact that brokers in management of the stock exchange were misusing their position for their personal gains. Demutualization would bring in transparency and prevent conflict of interest in the functioning of the stock exchanges.

7. Rolling Settlement

The trading cycle varied from 14 days for specified securities to 30 days for others and settlement took for another fortnight often this cycle was not adhered to. This was euphemistically often described as T+ anything. This has led to default and risks in settlement. In order to reduce the large open positions the trading cycle was a reduced over a period of time. The rolling settlement has seen settlement cycles coming down from a fortnight to five to three days at present. Rolling settlement on T+5 bases was introduced in phases. All scrips moved to rolling settlement from December 2001. T+5 gave way to T+3 from April 2002 and T+2 from April 2003.
The capital markets are very rapidly moving towards one-day settlement of transactions which is popularly known as T+1.

8. Dematerialization

In the physical system of transfer of securities and its settlement there were many problems and deficiencies. The trades were settled by physical movement of papers which was a time-consuming process. The system of transfer of securities was grossly inefficient and full of risk. Theft, forgery, mutilation of certificates and many other irregularities were rampant, and in addition, the issuer had the right to refuse the transfer of securities. To overcome the above difficulties and obviate the problems, the Depositories Act, 1996 was passed to provide for the establishment of Depository in securities. Its main objective was to ensure free transferability of securities with speed, accuracy and security by:

- Making securities of Public Limited Companies freely transferable subject of certain exceptions.
- Dematerialization of the securities in the depository mode.
- Providing for maintenance of ownership records in book entry form.

Accordingly, two depositories viz. National Securities Depository Limited (NSDL), Central Depository Services (India) Limited (CDSL) have been established, to provide instantaneous Electronic Transfer of securities. Thus the starting of process of Dematerialization of securities is a major reform. It has been made compulsory for all new initial public offers (IPO's) to be compulsorily traded in D-mat form. The admission to a depository for D-mat of securities has been made a condition for
making a public or rights either subscribing to securities in physical form or dematerialized form. Now it has also been made compulsory for public listed companies making IPO, of any security for Rs. 10 Crore or more to do the same only in D-mat form. Currently 99% of market capitalization is dematerialized and 99.9% of trades are settled by delivery.\textsuperscript{19}

9. Book Building

The process of making a public issue was quite time consuming and costly. Even the pricing decisions are quite difficult, as one has to guess about the public response. The process of book building was introduced as a solution. This has enabled the issuer to gauge the response of institutional investors and price the issue accordingly.\textsuperscript{20}

10. Trading in Derivatives

To assist market participants to manage risks through hedging, speculation and arbitrage, SCRA was amended in 1995 to lift the ban on options in securities. On 11\textsuperscript{th} May, 1998 the Governing Board of SEBI approved Dr. L.C. Gupta Committee report on “Derivatives Trading”. It was decided that SEBI will allow Derivatives trading in Phased Manner beginning with Index Futures. The absence of derivatives trading in our country deprived investors on the most effective and cost efficient tool for management of Investment Risk. Thus, there was no system by which investors could insulate themselves from systematic risks. Then there was a problem in starting trading in Derivatives because the term “securities” in the SCRA did not...
include the term “Derivatives “. The SCRA was thus further amended in December 1999 to expand the definition of securities to include Derivatives. The ban on forward trading, which was hindering introduction of trading in Derivatives was ultimately withdrawn. The Derivatives trading started on B.S.E. and the National Stock Exchange then in June 2000.

11. Settlement Guarantee

A variety of measures were taken to address the risk in the market. Clearing corporations emerged to assume counter party risk. Trade and settlement guarantee funds were set up to guarantee settlement of trades irrespective of default by brokers. These funds provide full novation and work as central counter party. The Exchanges/clearing corporations monitor the positions of the brokers on real time basis.

12. Central Listing Authority

The compliance with the listing requirements were being hitherto seen by each stock exchange on which the securities of the company are proposed to be listed. These requirements differed from exchange to exchange. SEBI has set up a Central Listing Authority (CLA), which would accord approval. This approval would enable all the stock exchanges, which the security is going to be listed, to list the securities at an early date. The CLA would act is a check on the fly by night operators who float public issues, since the listing norms would be uniformly applied as against the current practice where the norms could be flouted, if listing is to take place in a very small exchange where the listing requirements may by lenient.
13. Disclosure Norms for Private Placements

In the past few years, there was a rapid growth of private placement issues. Reasons for such rapid growth may be attributed to facts like, lower disclosure requirements, lower issue cost and faster source of financing. The private placements do not require detailed compliance with preparation of offer documents, which are required in case of a public issue. The argument that in private placement only big players like banks, institutions, mutual funds participate and therefore there is no need for stringent disclosure requirement is not valid since lack of information may result in bad investment—even for these players. Further, there were some issues of equity, which were placed privately there even the public participated. For better regulation of the private placements, it is SEBI and Department of Company Affairs (DCA) introduced minimum information for floating private placements.

14. Margin trading

In the process to provide better liquidity in the market, Margin Trading was permitted. In this securities are purchased by borrowing a portion of the transaction value and using the securities are used in the portfolio as collateral. It is aimed at increasing the purchasing power of the investors. This would lead to leveraging and expansion of portfolio.

15. Investor Protection

One of the important objectives of SEBI Act, 1992 is protecting the interest of investors in securities. The SEBI specifies the matters to be disclosed and the standard of disclosures required for the protection of investors regarding issues and
has been issuing various directions to all the intermediaries and other persons associated with the securities market for protection of interest of investors particularly in the primary market. In the stock exchanges also it has been made compulsory to constitute an Investors' Services Cell for redressal of investors' grievances. Similarly, an "Investors Protection Fund" has also been constituted in all the stock exchanges. In case a defaulter member fails to pay his client/investor, then subject to certain conditions a sum up to a maximum of Rs.50,000 can be paid by the stock exchanges out of this fund to the investor. The Department of Company Affairs has also set-up an "Investors Education and Protection Fund" for the promotion of investors' awareness and protection of their interests.

16. Corporate Governance and Clause 49 of the Listing Agreement

The concept of Corporate Governance has assumed great significance in India in the recent past. Even though the Companies Act provided a framework for corporate governance, defines the powers, duties and responsibilities of the Board, punishment for transgression of law there was a need for a comprehensive code of Corporate Governance. Corporate Governance deals with the laws, procedures, practices and implicit rules and determines a company's ability to take managerial decisions vis-à-vis its claimants in particular to its shareholders, creditors, clients, the state and the employees. Now there is a global consensus about the objective of good Corporate Governance. Keeping the above in view, Securities and Exchange Board of India appointed Kumar Manglam Birla Committee on Corporate Governance. The draft of the above committee was accepted by SEBI in its Board Meeting on 25.1.2000. Then the Kumar Manglam Committee Report on Corporate Governance was
accepted in total. The corporate governance code was made applicable to "A" Category Scrips of BSE, which were allowed for trading from March 31, 2001 and then to all listed companies within a three year time frame. The recommendations become applicable to such companies being listed for the first time, with immediate effect. In other words, all companies going for listing, irrespective of their size will need to comply with the requirement. The report contained two types of recommendations:

- The Mandatory recommendations.
- Recommendatory only.

The Securities and Exchange Board of India has got the Listing Agreement of stock Exchanges to include the provisions of corporate Governance in Clause 49 by all the stock exchanges compulsorily. Now it is the duty of the Stock Exchanges to take follow up action for necessary compliance by the listed companies in terms of the above clause.

17. Other Measures

The secondary market was facing the problem of liquidity and turnover was getting concentrated in specific scripts. While the number of listed scripts has grown very slowly, the number of scripts not traded has increased considerably. This phenomenon was seen in the fundamentally strong companies also. In order mitigate illiquidity in the market the market making mechanism has been introduced.
A central co-ordination and monetary committee has been established to construct and maintain a central registry of securities market participants and professionals, to provide for better surveillance.

Capital adequacy norms, segregation of client and broker account and due diligence by intermediary have been brought into the system to make the intermediary more accountable and transparent.

There is proposal for introduction of e-IPO (online initial public offer). Under this concept the application for allotment will be collected through terminals by the exchanges and are sent to the registrar for further processing and allotment.

The negotiated dealing system (NDS) has been put in place and the banks, primary dealers and financial institutions having SGL accounts and current accounts with RBI are eligible to participate in NDS. It provides an electronic dealing platform (similar to equity market platform) for these participants in government securities.

**Insurance Sector Reforms**

Prior to the reforms both life insurance and non life insurance business was organised as state monopoly. As part of economic liberalisation programme, the government appointed a Committee on Reforms of the Insurance Sector under the chairmanship of Sri. Malhotra. Accordingly, Insurance Regulatory and Development Authority was set up on April 19, 2000 and the insurance business was thrown open for private participation (including foreign equity participation).
Impact of Reforms on Corporate Sector

Capital markets have always had the potential to exercise discipline over promoters and management alike, but it was the structural changes created by economic reforms that effectively unleashed this power. Minority investors can bring the discipline of capital markets to bear on companies by voting with their wallets. They can vote with their wallets in the primary market by refusing to subscribe to any fresh issue by the company. They can also sell their shares in the secondary market thereby depressing share price. Financial Sector Reforms set in motion several key forces that made these forces far more potent than in the past.

Deregulation

Economic reforms have not only increased growth prospects, but have also made markets more competitive. This means that in order to survive, companies will need to invest continuously on a large scale. The most powerful impact of voting with the wallet is on companies with large growth opportunities that have a constant need to approach the capital market for additional funds.

Disintermediation

Meanwhile, financial sector reforms have made it imperative for firms to rely on capital markets to a greater degree for their needs of additional capital. As long as firms relied on directed credit, what mattered was the ability to manipulate bureaucratic and political processes; the capital markets, however, demand performance.
Globalization

Globalization of our financial markets has exposed issuers, investors, and intermediaries to higher standards of disclosure and corporate governance that prevail in developed capital markets.

Institutionalization

Simultaneously, the increasing institutionalization of capital markets has tremendously enhanced the disciplining power of the market. Large institutions (both domestic and foreign) in a sense, act as gatekeepers to the capital market. When they vote with their wallets and their pens, they have an even more profound effect on the ability of the companies to tap the capital markets. Indian companies that opened their doors to foreign investors have seen this power of the minority shareholder in very stark terms. International investors can perhaps be fooled for the first time about as easily as any other intelligent investor, but the next time around, the company finds that its ability to tap the international markets (GDRs) or other instrument has practically vanished. In the mid-90s, company after company in India has woken up in this manner to the power that minority shareholders enjoy when they also double up as gatekeepers to the capital market.

Tax Reforms

Tax reforms coupled with deregulation and competition have tilted the balance away from black money transactions. It is not often realized that when a company makes profits in black money, it is cheating not only the government, but also the minority
shareholders. Black money profits do not enter the books of account of the company at all, but usually go into the pockets of the promoters.

The past few years have witnessed a silent revolution in Indian corporate governance where managements have woken up to the disciplining power of the capital markets. In response to this power, the more progressive companies are voluntarily accepting tougher accounting standards and more stringent disclosure norms than are mandated by law. They are also adopting more healthy governance practices.21

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