CHAPTER - 2
EVOLUTION AND GROWTH OF INDIAN CAPITAL MARKET
Security markets in India have grown through various stages. A brief chronological account of the growth process is as follows:

2.1 Evolution:

The origin of stock market in India can be traced to the later part of the eighteenth century. The earliest security dealings were transactions in loan securities of the East India Company, the dominant institution of those days. Corporate shares came into the picture by 1830's, and assumed significance with the enactment of the Companies Act in 1850. The introduction of limited liability marked the beginning of the era of modern joint stock enterprises. This was followed by the American Civil War in 1860-65. However, the bubble burst with the end of the Civil War and a disastrous slump followed. It lasted for a long time. It also resulted in complete ostracism of the broker community. The tremendous social pressure on the brokers led to their forming an informal association which later gave birth to the Native Share and Stock Broker's Association [now known as the Bombay Stock Exchange] in 1887. This stock exchange played a major role during the phase of recovery from the seven-year depression. It continued to grow in stature and
size of operations and became the nerve centre of all financial activity and the first to be recognized by the Government of India.

The establishment of cotton textile industry and the increased share business led to the establishment of the "Ahmedabad Share and Stock Broker's Association" in 1894, which later came to be known as the Ahmedabad Stock Exchange.

The beginning of the twentieth century saw the birth of the Swadeshi movement. It inspired the industrial revolution and enthusiasm for development of transport and communication. The swadeshi movement also led to the establishment of many new industries like plantation, mining, and the Tata Iron and Steel Company.

In 1908, the boom burst and severe depression caused huge losses to the investors. The acute depression caused dispute and violence among brokers and led to a communal riot in May 1908. A need for an organized body was felt for the mutual protection and safety of the broker and the trade. Accordingly, "The Calcutta Stock Exchange Association" was founded in June 1908.

With the beginning of First World War, panic and pessimism started in the business circles, all imports into India ceased and the Indian manufactures were faced with a boom. Mills, factories and workshops worked round the clock, fabulous profits were earned and good dividend declared and the stock exchange "soon became the centre of
Evolution and Growth of Indian Capital Market

attraction for all." However, the boom also led to the formation of many rival stock exchanges.

After the first World War, there was a rapid increase in the number of textile and plantation companies in South India. To cater to this expanding trade in plantation and textile shares, a stock exchange was organized in Madras the 4th September 1937, under the name of the "Madras Stock Exchange Association (Pvt.) Limited", which later came to be known as the "Madras Stock Exchange Ltd."

On 3rd September 1939, the Second World War broke out. It caused a quick boom in the share prices for a short period. However, France's defeat in May 1940 gave a rude shock to the Indian Stock Market. As a result, the Calcutta Stock Exchange remained closed for six weeks and forward dealings were suspended in Bombay Stock Exchange. In June 1940, minimum prices were fixed for all government securities and certain industrial scrips.

On 15 October 1942, forward trading was suspended indefinitely but was continued under guise of badla. Later on, the Government banned badla on the floor of stock exchange but it continued to take place outside the floor of exchange.

In 1943, the picture completely changed, India was identified as a supplier base by the allied forces to fuel the war machine. Mills, factories and workshops were running round the clock. So the prosperity increased by leaps and bounds, with money becoming cheaper and paper
wealth multiplied. The Second World War also resulted in a sharp boom and mushroom growth in the number of stock exchanges but many of them perished during the slump that followed. Most of the other Stock Exchanges languished till 1956, when the Government came out with a comprehensive legislation called the 'Securities Contract [Regulation] Act' to regulate the functioning of stock exchanges. This legislation made it mandatory on the part of the stock exchange to secure recognition from the Central Government. Only the established stock exchanges in Bombay, Ahmedabad, Calcutta, Madras, Delhi, Hyderabad and Indore were recognized under the Act. At present, there are twentythree such recognized stock exchanges in India, including the OCTEI and National Stock Exchange.

The recognized stock exchanges operate under the Rules, By-laws and Regulations approved by the Government and they constitute an organized capital market for securities issued by the Central and State Governments, Public bodies and Joint Stock Companies.

During 1992-93, the Finance Minister, Dr Manmohan Singh, announced a decision to allow reputed foreign investors such as Pension funds, Investments trusts, Asset Management Companies etc. to invest in capital market. As on 31st March 1995, there were 308 odd FIIs recognized by SEBI, mostly operating from Bombay.

With a view to encouraging professionalism and rendering better services to the investing public, the
Government of India has allowed a company, formed under either the provisions of Section 12 [of the Companies Act, 1956] or Section 322 to become a member of the stock exchange, of course, subject to certain conditions. Till mid 1995, there were approximately 21 corporate members in the Bombay Stock Exchange.

2.2 INDIAN CAPITAL MARKETS:

The term 'Capital markets' is used for the financial system of an economy at one level. However, it is also used narrowly for the primary and secondary markets through which savings are mobilised directly without financial intermediation, thus excluding other institutions like banks, financial institutions, insurance companies etc. which transform the risk and maturity of their liabilities (Savings mobilised). The importance of capital markets relative to other 'institutions' in India has been increasing over the years, particularly so after 80s. Recently in 1991-92, with a series of measures taken by government to liberalise and deregulate the economy, capital markets seem to have grown rapidly both in terms of mobilisation of funds as well as trading activity. The abolition of the office of the Controller of Capital Issues (CCI), which used to regulate pricing and other modalities of public issues, is one important event which had a direct import and, hence, worth taking note of. The summary of some of the indicators is given in Table 2.1. that follows.
TABLE - 2.1

GROWTH OF CAPITAL MARKET

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. No. of Stock exchanges</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>21</td>
<td>22</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>2. No. of listed Companies</td>
<td>1125</td>
<td>1203</td>
<td>1599</td>
<td>1852</td>
<td>2265</td>
<td>8480</td>
<td>8925</td>
<td>7811</td>
<td></td>
</tr>
<tr>
<td>3. No. of stock issues of listed companies</td>
<td>1506</td>
<td>2111</td>
<td>2853</td>
<td>3230</td>
<td>3897</td>
<td>9842</td>
<td>11310</td>
<td>12026</td>
<td></td>
</tr>
<tr>
<td>4. Capital of listed Companies (Rs. Cr.)</td>
<td>270</td>
<td>753</td>
<td>1812</td>
<td>2814</td>
<td>3973</td>
<td>40796</td>
<td>56533</td>
<td>152322</td>
<td></td>
</tr>
<tr>
<td>5. Market value of capital of listed Companies (Rs. Cr.)</td>
<td>971</td>
<td>1292</td>
<td>2675</td>
<td>3273</td>
<td>6750</td>
<td>354106</td>
<td>252845</td>
<td>541050</td>
<td></td>
</tr>
<tr>
<td>6. Average Capital per listed company (Rs. in lakh)</td>
<td>24</td>
<td>83</td>
<td>113</td>
<td>141</td>
<td>175</td>
<td>629</td>
<td>816</td>
<td>1287</td>
<td></td>
</tr>
<tr>
<td>7. Average market value of capital per listed company (Rs. lakh)</td>
<td>86</td>
<td>107</td>
<td>167</td>
<td>177</td>
<td>298</td>
<td>5404</td>
<td>3651</td>
<td>4499</td>
<td></td>
</tr>
</tbody>
</table>


In the India, there are 23 recognised exchanges as on 31st March, 1994. Out of these, the Bombay Stock Exchange is the largest in terms of listed securities and volume of trading. The BSE accounted for 46% of the listed companies, 50% listed capital, 74% of market capitalisation as on
31st March 1994. It was also estimated that BSE alone accounted for 75% trading volume in country (Source: Stock Exchange Official Directory, 1995, Vol-2). A comparison is given below in Table 2.2 which shows the comparison of the top five exchanges of country.

**TABLE 2.2**

**COMPARISON OF TOP 5 EXCHANGES**

**[AS ON 31ST MARCH 1994]**

<table>
<thead>
<tr>
<th>Name of Stock Exchange</th>
<th>No. of companies Listed</th>
<th>No. of stock issues</th>
<th>Listed [Rs.cr] capital</th>
<th>Market value [Rs. cr.]</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Bombay</td>
<td>3585</td>
<td>7306</td>
<td>75635</td>
<td>398432</td>
</tr>
<tr>
<td>2. Calcutta</td>
<td>2673</td>
<td>3319</td>
<td>33647</td>
<td>214979</td>
</tr>
<tr>
<td>3. Delhi</td>
<td>2616</td>
<td>3180</td>
<td>54462</td>
<td>287061</td>
</tr>
<tr>
<td>4. Ahmedabad</td>
<td>1532</td>
<td>1861</td>
<td>51501</td>
<td>142862</td>
</tr>
<tr>
<td>5. Madras</td>
<td>715</td>
<td>1040</td>
<td>24746</td>
<td>181525</td>
</tr>
<tr>
<td>6. All India</td>
<td>7811</td>
<td>12026</td>
<td>152322</td>
<td>541050</td>
</tr>
</tbody>
</table>


Table 2.3 reveals the structural pattern of listed stock of different stock exchanges of India.
## TABLE 2.3
**Structural Pattern of Listed stock**
*(As on 31st March 1994)*

<table>
<thead>
<tr>
<th>Exchange</th>
<th>No. of Stock Issues</th>
<th>Capital Listed (Rs. Cr.)</th>
<th>Market Value (Rs. Cr.)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Equity</td>
<td>Deb./ Bonds</td>
<td>Pref.</td>
</tr>
<tr>
<td>Bombay</td>
<td>3585</td>
<td>5570</td>
<td>1500</td>
</tr>
<tr>
<td>Calcutta</td>
<td>2673</td>
<td>2663</td>
<td>306</td>
</tr>
<tr>
<td>Delhi</td>
<td>2616</td>
<td>2554</td>
<td>466</td>
</tr>
<tr>
<td>Ahmedabad</td>
<td>1532</td>
<td>1532</td>
<td>266</td>
</tr>
<tr>
<td>Madras</td>
<td>715</td>
<td>715</td>
<td>237</td>
</tr>
<tr>
<td>Hyderabad</td>
<td>371</td>
<td>371</td>
<td>44</td>
</tr>
<tr>
<td>M. Pradesh</td>
<td>140</td>
<td>140</td>
<td>21</td>
</tr>
<tr>
<td>Bangalore</td>
<td>393</td>
<td>393</td>
<td>161</td>
</tr>
<tr>
<td>Pune</td>
<td>131</td>
<td>131</td>
<td>44</td>
</tr>
<tr>
<td>Cochin</td>
<td>127</td>
<td>127</td>
<td>42</td>
</tr>
<tr>
<td>Ludhiana</td>
<td>222</td>
<td>225</td>
<td>31</td>
</tr>
<tr>
<td>U.P</td>
<td>793</td>
<td>793</td>
<td>63</td>
</tr>
<tr>
<td>Guwahati</td>
<td>218</td>
<td>307</td>
<td>9</td>
</tr>
<tr>
<td>Mangalore</td>
<td>29</td>
<td>30</td>
<td>10</td>
</tr>
<tr>
<td>Patna</td>
<td>48</td>
<td>46</td>
<td>12</td>
</tr>
<tr>
<td>Bhubaneswar</td>
<td>35</td>
<td>36</td>
<td>11</td>
</tr>
<tr>
<td>Rajkot</td>
<td>26</td>
<td>26</td>
<td>4</td>
</tr>
<tr>
<td>Baroda</td>
<td>95</td>
<td>95</td>
<td>19</td>
</tr>
<tr>
<td>Jaipur</td>
<td>239</td>
<td>239</td>
<td>2</td>
</tr>
<tr>
<td>OTCEI</td>
<td>24</td>
<td>19</td>
<td>5</td>
</tr>
<tr>
<td>All India</td>
<td>7811</td>
<td>9524</td>
<td>1840</td>
</tr>
</tbody>
</table>


* The figures pertain to 31st March, 1992.
# The figures pertain to 31st March, 1993.
2.3 RECOGNIZED STOCK EXCHANGES IN INDIA

The pace of growth of the stock exchanges was slow till 80's. After that, there was a capital market revolution in the country. This was due to gradual liberalization of economic and industrial policies. The shift from command economy to a market economy brought the importance of stock exchanges into lime light.

At present there are twenty-three such recognized stock exchanges in India, including the OTCEI and National Stock Exchange. The name of these stock exchanges with their geographical location, and the dates of their receiving government recognition are given in the Table 2.4:
**TABLE 2.4**

**THE RECOGNIZED STOCK EXCHANGES OF INDIA**

<table>
<thead>
<tr>
<th>Sr No</th>
<th>Name of the exchanges &amp; location</th>
<th>Date of initial recognition</th>
<th>Latest date of renewal of recognition</th>
<th>Recognition valid until</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>The Stock Exchange Bombay</td>
<td>31-3-1957</td>
<td>—</td>
<td>Permanent</td>
</tr>
<tr>
<td>2.</td>
<td>The Stock Exchange, Ahmedabad</td>
<td>16-9-1957</td>
<td>1-3-1982</td>
<td>Permanent</td>
</tr>
<tr>
<td>3.</td>
<td>The Calcutta stock Association Ltd., Calcutta</td>
<td>10-10-1957</td>
<td>14-4-1980</td>
<td>Permanent</td>
</tr>
<tr>
<td>5.</td>
<td>The Delhi Stock Exchange Association Ltd., New Delhi</td>
<td>9-12-1957</td>
<td>1-3-1982</td>
<td>Permanent</td>
</tr>
<tr>
<td>7.</td>
<td>Madhya Pradesh Stock Exchange Ltd., Indore</td>
<td>24-12-1958</td>
<td>22-12-1988</td>
<td>Permanent</td>
</tr>
</tbody>
</table>

Contd...
Contd....

<table>
<thead>
<tr>
<th>Sr No</th>
<th>Name of the exchange &amp; location</th>
<th>Date of initial recognition</th>
<th>Latest date of renewal of recognition</th>
<th>Recognition valid until</th>
</tr>
</thead>
<tbody>
<tr>
<td>17.</td>
<td>Bhubaneswar Stock Exchange Association Ltd., Bhubaneswar</td>
<td>5-6-1989</td>
<td></td>
<td>4-6-1994</td>
</tr>
</tbody>
</table>

2.4 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI):

The Securities and Exchange Board of India (SEBI) was constituted by the Government of India on 12 April 1988 as a non-statutory body to promote orderly and healthy development of the securities markets and to provide adequate investor protection. Dr. S.A. Dave, Formerly Executive Director, Industrial Development Bank of India, was appointed as the first Chairman of SEBI.

On 31st March 1992, the President of India gave statutory recognition to SEBI by promulgating an ordinance. The ordinance was replaced by the Securities and Exchange Board of India Act, 1992 on 4th April 1992, which was deemed to have came into force on 30th January 1992. Under the Provisions of the Act, it is the duty of SEBI to protect the interest of investors in securities and to promote the development of, and to regulate the securities market.

2.4.1 OBJECTIVES OF SEBI:

SEBI, thus, has three objectives or duties cast upon it by the Act:

[A] to protect the interest of investors in securities.
[B] to promote the development of securities markets,
[C] to regulate the securities markets.

Powers under the Securities Contracts (Regulation) Act were transferred to SEBI and there are:

[1] Power to call for periodical returns from recognized stock exchanges.
[3] Power to conduct research and other functions.
[5] Power to prohibit fraudulent and unfair trade practices relating to securities.
[6] Power to regulate substantial acquisition of shares and take over of companies.
[7] Power to promote investor's education and trading of intermediaries in capital market.
[8] Power to compel listing of securities by public companies.
[10] Power to grant registration to market intermediaries.
[12] Grant approval to the laws of any recognized stock exchange for the regulation and control of contracts.
[14] Power to make or amend bylaws of recognized stock exchanges.
[15] Licensing of dealers in securities in certain areas.
[16] Power to register and regulate the working of collective investment schemes including mutual funds.
[17] Call for any information or explanation from recognized stock exchanges or its members.

SEBI, as a regulatory and development board, thus has wide and varied powers. SEBI's effort so far include taking measures for efficiency, reforms and transparency in primary
and secondary market, regulating of mutual funds and market intermediaries and introduction of form 2A and stock invests, and pricing of issues and registration of foreign institutional investors.

SEBI cannot act independently. It is bound by directions of questions of policy given by central government from time to time in writing. SEBI is obliged to make an annual report to the Government each year, giving therein a true and full account of its activities, policies and programmes.

2.4.2 CURRENT STATUS OF SEBI:

On 27th January 1995, the Government of India, by an ordinance, called the Securities Laws Ordinance 1995, strengthened the regulatory powers of the SEBI over the capital market intermediaries and companies. So far the SEBI had to seek the approval of the Union Government for effecting changes in existing regulations regarding market intermediaries. The ordinance gave SEBI a free hand in this regard. In addition, the Finance Ministry extended Government regulatory powers to the SEBI over corporates in the issuance of capital, the transfer of securities and other related matters. The securities laws empowered SEBI to impose monetary penalties on capital market intermediatives and other participants for a range of violations. The existing SEBI Act provides for the suspension and cancellation of registration and for the prosecution of intermediaries. By allowing for monetary penalties, the
Government brought violation of the provisions of the SEBI Act under civil law proceedings which was hitherto under criminal law. With a view to inducting more professionals in the SEBI Board, the Government has provided for the deletion of the existing provision which disqualifies a member of the Board once he is appointed as a director of a company. The law also empowers SEBI to summon the attendance of and call for documents from all categories of stock market intermediaries, including persons in the securities market. It has been given the power also to issue direction to all concerned parties so as to protect the investor interest and ensure orderly development of the securities market. The listing agreement has also been brought under the purview of the SEBI Act.

2.4.3 ORGANISATION OF SEBI:

After it became a statutory body, SEBI restructured its organisation and rationalized it in line with its expanded range and scope of activities. It has divided its activities into five operational departments, each headed by an executive director. There are two other departments, viz Legal Department and Investigation Department, also headed by officials of the rank of Executive Directors. All these departments are further sub-divided into divisions, each headed by a division chief with specific responsibilities.

1) Primary market department:

This Department takes care of policy, intermediaries, regulatory provisions, investor grievance and guidance. It
looks after all the policy matters and regulatory issues for the primary market and market intermediaries, matters pertaining to self-regulatory organisation (SROS) and redressal of investor grievances.

2) The issue management and intermediaries department:

This takes care of whetting of offer documents and other things like registration, regulation and monitoring of issue-related matters.

3) The secondary market department:

This department looks after the policy, operations, exchange administration, new investment etc. It is also responsible for monitoring market surveillance and insider trading. It takes care of all the policy and regulatory issues for the secondary market, administration of the major stock exchanges and all other matters related to it. In addition, it also overseas the smaller stock exchanges and regulates the non-members intermediaries such as sub-brokers.

4) The institutional investment department:

This department looks after mergers and acquisitions, research and publications and international relations. It makes policy for FIIS, mutual funds etc. and performs other sundry functions like bringing out publications, getting membership of international organisations etc.

5) The legal and investigation departments:

The legal department, under the supervision of the general counsel, takes care of all the legal matters of
SEBI. The investigation department carries out inspections and investigations under the supervision of the chief Investigator.

The SEBI also has two advisory committees, one each for primary and secondary markets, to provide advising inputs in framing policies and regulations. The committees are, however, non-statutory in nature and the SEBI is not bound by their advise. The SEBI has recently opened regional offices at New Delhi, Calcutta and Madras, with Bombay being the headquarters. The regional offices are assigned the task of covering operations in the northern, eastern and southern region respectively. The relevant details are given in Exhibit 2.1.
EXHIBIT 2.1

ORGANISATION OF THE SEBI BOARD

Finance ministry nominee → chairman SEBI → Law Ministry nominee → RBI nominee

Executive Director Primary markets division

Executive Director Secondary markets division

Chief legal division

Chief investigation division

Executive Director, International Institutions, Mergers & Acquisitions, Research & Publications, International Regulations Divisions
2.5 TYPES OF SECURITIES TRADED:

Securities are written evidences of ownership giving their holders the right to demand and receive property not in their possession. The Securities Contracts Act, 1956 provides that securities include:

1) Shares, scrips, stocks, units, bonds, debentures or other marketable securities of like nature in or of any incorporated company or other corporate bodies.

2) Government securities,

3) Rights or interests in securities.

Classification of securities traded in stock exchanges:

Securities can be classified on the basis of return offered on investment and the source of their issue. A brief account of types of securities traded on the bourses is as follows:

1) Corporate debentures bonds:

The Indian Company Act, 1956, does not define the meaning of "debenture" except that it may include debenture stock. A debenture may be regarded as a debt instrument with a promise to pay interest and repay the principal on maturity.

In American terminology, only unsecured bonds are termed as debentures, whereas secured creditorship security is termed as a "bond".

The debenture holders cannot exercise control over the company and do not have a voice in its management.

A) Naked unsecured debentures:

Debentures that do not carry any charge on the assets
of the company are known as naked or unsecured debentures. The holders of these debentures do not have any security with regard to the repayment of Principal or interest thereon.

B) Secured or mortgage debentures:

Debentures that are secured by a mortgage of the whole or part of the assets of the company are known as mortgage debentures or secured debentures.

C) Perpetual/non-redeemable debentures:

Where the debentures are redeemable on the occurrence of specific events which may not take place for an indefinite period eg winding up, are known as perpetual debentures.

D) Bearer debentures/unregistered debentures:

These debentures are payable to the bearer and are transferable by delivery and no stamp duty is payable on the transfer. The debentures are not registered in the books of the company but are entitled to claim interest and repayment of Principal to the investors.

E) Registered debentures:

These debentures are payable to registered holders. A registered holder is a person, whose name appears on the debenture certificate / letter of allotment and is registered in the company's register of debenture holders maintained under Section 152 of Companies Act, 1956.

F) Fully or partly convertible debentures:

In case of fully-convertible debentures, the entire
force is converted into equity shares at the expiry of certain periods. In case of partly-convertible debentures, the convertible portion is converted into equity at the expiry of certain periods, the non-convertible portion is redeemed at the expiry of a certain period.

G) Non-convertible debentures:

Non-convertible debentures are those debentures that are not converted into equity shares but Principal redeemed at the expiry of a certain period.

2) BONDS:

Different types of bonds traded at bourses are listed below:

A) Bullet bond:

A bond that repays maturity value in one lump-sum at maturity.

B) Sinking fund bond:

A bond that repays maturity value in more than one instalment.

C) Callable bond:

A callable bond gives the corporation an option to buy back the bonds at the stated Price before their maturity. The call provision gives a company flexibility in its financing. A company issuing callable bonds can refinance the funds at lower interest cost.

D) Refunding bonds:

The process of issuing new bonds and using the proceeds, either for redeeming the older bonds or
exercising a call option, is called a refunding bond.

E) Zero coupon bonds:
Zero coupon bonds pay no interest prior to maturity.

F) Deep discount bonds:
These bonds are sold at a large discount on their nominal value and mature at par value. There are no interest payments on these bonds and the investors obtain their return as assertion to the par value of the instrument over its life.

G) Option bonds:
Option bonds are again of two types:
Cumulative opening bond:
In case of cumulative bonds, the interest is accumulated and is payable on maturity.
Noncumulative option bond:
In case of noncumulative bond, interest is payable at periodic intervals.

3) EQUITY SHARES:
- Equity shares carry voting rights at the general meeting of the company and have the right to control the management of the company.
- Equity shares carry the right to share in the profits of the company in the form of distribution of dividend and bonus shares.
- In the event of winding up of the company, the equity share capital is repayable only after repayment of the claims of all the creditors and preference share
The holders of equity shares in a company are the owners of the business.

4) PREFERENCE SHARES:

This type of corporate security has ownership like an equity and also fixed income like debentures. These shares have preferential rights for payment of dividend along with arrears, if any. They are paid fixed dividend before any dividend as declared to the equity shareholders. It also has preferential right over equity in the matter of payment of capital and share of assets in the event of winding up of the company, subject to the claims of creditors. However, the preference shareholders do not enjoy any voting rights like the equity shareholders except when any resolution affects their rights.

Types of preference shares:

A) Cumulative preference shares:

The dividend payable on the shares accumulates till it is paid off. The arrears of preference divided are carried forward to be paid out of the profit of subsequent years.

B) Non-cumulative preference shares:

The dividend does not accumulate. If there is no profit or inadequate profit in any year, these shares are not entitled to any dividend for that year.

C) Convertible preference shares:

These preference share are convertible into equity shares at the end of a special period and are quasi-equity
shares.

D) Irredeemable preference shares:

When the preference shares are not redeemable except on the occurrence of certain specified events, which may not take place for an indefinite period, such shares are known as irredeemable preference shares.

E) Redeemable preference shares:

These are redeemed after a certain specified time period.

F) Cumulative convertible preference shares:

This type of security was introduced by the Government in 1985. The dividend payable is fixed at 10%. The entire issuing of cumulative convertible preference would be converted into equity shares between 2 and 5 years as may be approved by the SEBI.

5) Non-voting shares:

These non-voting shares are not yet issued in the Indian capital market. But there is a proposal to allow companies to raise funds through these instruments in the near future. It would require an amendment to the Companies Act, 1956 to make such a provision.

These instruments are similar to equity in all respects except that they do not enjoy voting right. These instruments are listed separately on the stock exchanges. The investors in these instrument are entitled to rights and bonus in the same proportion as is being offered to equity shareholders with voting rights. However, these share
holders are entitled to voting rights if dividends remain unpaid for two consecutive years until such time as two consecutive dividends are paid again.

2.5.1 MUTUAL FUNDS:

Mutual funds are trusts which accept savings from investors and invest the same in diversified financial instruments in terms of the objectives set out in the trust deed, with a view to reducing their risks and maximizing their income and capital appreciation for distribution to the members on a pro rata basis.

Types of mutual funds:

Mutual funds can be classified into the following three broad categories on the basis of portfolio, functions and geographical boundaries:

1) Portfolio classification of mutual funds:

Mutual funds differ with reference to the types of instruments in which the money has been invested as per the requirements of the investors. These are specific mutual funds structured for meeting a particular investor’s purpose.

A) Bond funds:

Provide fixed return for those who desire safety.

B) Equity funds:

Equity funds are established for those who are willing to accept significant risks in the hope of very high return. All Growth Fund’s are in fact equity funds. They take high risk by investing large portion of funds in equity which is
expected to yield high returns.

C) Income funds:

Funds are invested in equity which pay consistently high dividend (such as blue-chip companies). The investors are assured of a regular income over a given period of time.

D) Money market funds:

Money market mutual funds are used in short-term liquid assets like certificates of deposit, treasury bills and commercial papers.

E) Specialized funds:

Specialized mutual funds envisage specialized investments in securities of firms of certain industries or specific income producing securities, eg ICICI power fund.

F) Leveraged funds:

Leveraged funds or borrowed funds are used in order to increase the size of the value of portfolio and benefit the shareholders by gains exceeding the cost of the borrowed funds.

G) Balanced funds:

Some mutual funds are called 'Balanced funds' where assets are a judicious mixture of industrial equity and bonds.

H) Growth funds:

Growth funds have the principal objective of capital appreciation of the investment over a period.

I) Performance funds:

Performance funds were set up in the USA in 1960 to
seek large profits on investments in high-flying equity stocks.

J) Speciality funds:

These funds, as the name goes, invest in equity shares of good track record companies which offer long-term capital growth and provide dividend income.

K) Dual purpose funds:

Income and growth are the two objectives which are achieved by offering half of the amount of funds to those investors who wish regular income and half to those who wish growth. There are no such funds in India.

L) Real estate funds:

Real estate funds are issued like any other company's new issues. They are listed and quoted at the stock exchange.

2) Functional classification of mutual funds:

Functional classification of mutual funds is based on the basic characteristics of the mutual fund schemes offered to the public for the subscription of mutual funds on this basis are classified into two broad types, viz

A) Open ended mutual funds:

The holders of the shares in the fund can resell them to the company issuing mutual fund at any time, eg Kothari-Pioneer prima floated by Kothari Pioneer Mutual Fund in October 1993.

B) Close ended mutual funds:

A closed-ended fund investment company has definite
target amount for the funds and cannot sell more shares after its initial offering. The units of close-ended funds are not redeemable at their Net Asset Value as are open-ended funds, eg Canstock, Canshare, Mastershare, the SBI Magnum etc.

3) Geographical classification of mutual funds:

A country's boundary provides the territorial restriction on the sale and purchase of mutual fund units or shares as is the case in commodities the trade of or services. In view of this, mutual funds which operate within the national boundaries are different from those which are meant for subscription by foreigners or nationals leaving the country's boundaries. This classification is two types, viz

A) Domestic mutual funds:

Domestic mutual funds are the saving schemes which mobilize the savings of the nationals within the country, eg UTI, GIC, LIC mutual funds etc.

B) Offshore mutual funds:

The offshore mutual funds scheme is to attract foreign capital for investment in the country of the issuing company.

2.5.2 WARRANTS:

A share warrant is an option to the investor to buy a specified number of equity shares at a specified price over a specified period of time.

Warrants are of the following types:
A) Detachable warrants:

These warrants are issued with host instrument, like convertible or non-convertible debentures or equity shares and are immediately detachable. They are traded in the secondary market as separate instruments.

B) Puttable warrants:

These warrants are those which confer a right on the investor to sell the warrant back to the company at a fixed price before the expiry of a fixed period and limit his risk.

C) Wedding warrants:

These warrants are attached to the host debentures and can be exercised if the host debenture is surrendered.

D) Naked warrants:

These warrants are issued separately and not as part of the bond or debentures issue. The holders have the option to convert the warrant into debt or equity or some other asset of the issuer.

2.5.3 SECURED PREMIUM NOTES (SPN):

SPN is a new instrument which was issued by the Tata Iron and Steel Co. Ltd. to its shareholders in June 1992. The salient features of the instrument are as follows:

a) The SPN is issued at a nominal value and does not carry an interest.

b) The SPN is redeemed by repayment in several instruments at a premium over the face value.

c) The instrument is secured by mortgage of all the
immovable properties of the company.

2.5.4 FLOATING RATE NOTES (FRNs):

It is a debt instrument with a variable interest rate, wherein the interest is adjusted periodically, based on the variation in reference rate.

2.5.5 STOCK INVEST:

A new financial instrument called "stockinvest" was introduced which is to be used by the investors in lieu of the application money while applying to a capital issue. The amount will remain credited to the investor's account in his bank but under the custody of his banker till the allotment and will carry interest. The issuing company will be able to encash the instrument only when the shares/debentures are allotted to the investor.

2.5.6 OPTIONS:

Options are contracts that give the holder the right, but not the obligation, to buy or sell on underlying future contract at a specified price.

[A] Call options:

A call option is a contract giving its owner the right to buy a specified number of rights shares of a company at a specified exercise price up to any time on or before the given date.

[B] Put option:

A put option gives the holder the right, but not an obligation, to sell a fixed number of equity shares of a company at a specified price at any time on or before the
given date.

[C] Stock index options:

In a stock index option, an investor, who buys the options, invests in the over all business-trend as opposed to investing in companies.

2.6 RECOMMENDATION OF NEW FINANCIAL INSTRUMENTS:

The study Group constituted by the Government on 27th March 1991, with Mr. M.J.Pherwani as the chairman, to formulate guidelines for the issue of new instruments, recommended the following instruments, some of which have already been issued in the market:

1) Non-voting shares.
2) Detachable equity coupons/warrants.
3) Participating preference shares.
4) Participating debentures.
5) Convertible debentures with options.
6) Third party convertible debentures.
7) Mortgage backed securities.
8) Convertible debentures redeemable at premium.
9) Debt for equity swap.
10) Zero coupon convertible bonds.

After having examined the various types of securities, it is logical to look at some new trends in stock-trading in India.

2.7 OVER THE COUNTER EXCHANGE OF INDIA:

Small investors all over the country are faced with problems of access, liquidity, delays in payment and deliv-
Evolution and Growth of Indian Capital Market

ery and uncertainty regarding the prices at which their shares are bought or sold. Likewise, prohibitive issue costs, restricted access to the markets, and administered pricing of their shares are the main problems faced by small companies. Over the counter exchange of India has been set up to provide solution to these problems of companies and investors.

OTCEI is a company incorporated under Section 25 of the Companies Act, 1956. The main objective of OTCEI is setting up and operating an Over The Counter Exchange (the OTC exchange) in India. The OTC exchange is a recognized stock exchange under Section-4 of the Securities Contract (Regulation) Act, 1956. Hence, the companies listed on the OTC exchange enjoy the same status as companies listed on any other stock exchange in the country, with regard to taxes and interest rates on borrowing.

Unique features:

The unique features of the OTC exchange are:

Ringless:

For greater accessibility to the investors, the OTC exchange has eliminated the trading ring. Instead, trading takes place through a network of computers of OTC dealers located at several places within the same city and even across cities. These computers allow dealers to quote, queries and transact through a central OTC computer using tele-communication links.
National Reach:

Unlike the other stock exchanges, the OTC exchange has a nationwide reach, enabling widely dispersed trading across cities, resulting in greater liquidity. Companies, thus, have the unique benefit of a nation-wide listing and trading of their scrips, by listing at just one exchange, i.e. the OTC exchange.

Computerized:

All activities of the OTC trading process are computerized for a more transparent, quick, and disciplined market. The trading mechanism involves interaction with the central OTC computer, through tele-communication lines and no face-to-face contact is involved.

Exclusive list of companies:

The OTC exchange will not list and trade in companies listed on any other exchange. It uses an entirely new list of companies "sponsored" by the members of the OTC exchange.

Players in the OTC market:

The O-CEI has two players, viz members and dealers, instead of brokers. Both the members and the dealers can perform the following activities:

1) Broking, i.e. buying and selling securities as ordered by their clients.
2) Trading on their own account at the prices quoted by the market-makers.
3) Becoming voluntary market-makers. Both members and dealers can both carry out voluntary market-making in
any scrip for a period of at least three months continuously.

Additional market-making:

Every scrip will have a sponsor and an additional marketmaker, where the additional market-making would be for at least one year continuously.

In addition to the above activities, the members of the OTC exchange will carry out the vital function of sponsorship, which involves the following:

[1] To appraise a company / project to ensure that the company has technological and financial viability.
[2] All government regulations are satisfied, raw material and infrastructural inputs as well as marketing and financial inputs, are adequately tied up.
[3] To certify to the OTCEI with regard to the investment worthiness of the company and its project.
[4] To value the shares of the company.
[5] To obtain the CCI and other governmental clearances for the issues of the company.
[7] To compulsorily serve as a marketmaker in the issued scrip for at least three years from the date trading commences.

Listing at the OTC exchange:

Companies with an issued equity capital in the range of Rs. 100 to Rs. 300 lakh may list on the OTC exchange.
provided:

- For an issued equity from Rs.300 lakh, they offer to the public at least 40% of issued equity or Rs.120 lakhs, whichever is higher.
- For an issued equity of Rs.100 lakhs to Rs.300 lakhs, they satisfy the existing norms for listing as on any other stock exchange in the country.
- They are not in the investment/leasing/hire purchase/amusement park business.
- They are MRTP/FERA companies with an issued equity of at least Rs.300 lakhs. Companies can go public on the OTC exchange by two methods, as shown in Exhibit 2.2

EXHIBIT 2.2
METHODS OF OFFER

![Diagram]

- **a) Primary issue:**
  As in the new issues, companies directly offer their shares to the public. The sponsor for these shares mainly carries out the function of issue management, and acts as the sole underwriter. He may sub-write his liability with a
syndicate of members and dealers.

b) Secondary issue:

Companies may offload the shares to be offered to the public by the sponsor at an earlier date. The sponsor may hold these shares till these are ready for public participation.
The listing procedure is shown in Exhibit 2.3

EXHIBIT 2.3

STEPS OF LISTING

- Company
  - Appoints sponsor
  - Sponsor appraises the project
  - Consults OTCEI
  - Gets CCI consent
  - Gets all statutory consents
  - Registers with OTCEI
  - Places Equity

- Notifies OTCEI
  - Makes issue
  - Listing application
  - OTCEI approves allotment
  - Allotment granted
  - Listing granted
  - Trading commences
TRADING ON THE OTC EXCHANGE:

The trading system is shown in Exhibit 2.4

EXHIBIT 2.4

OTC MARKET IN OPERATION

Bank --------------------- OTC Central Computer
Registrar
Telecom. PTI Computer Module
Thru modem
OTC Scan
Counter A

Thru modem
OTC Scan
Counter B

Trading mechanism:

In the initial public offer, or when scrip is bought, on OTC counter receipt (CR) is issued.

Four copies of such receipt will simultaneously be prepared - one for the OTCEI and one for the registrar.

Before issuing the CR, all transfer deeds along with relevant CRS are sent to the custodian/registrar.

When an investor comes to a counter to sell, he produces the CR. The CR particulars of the counters which sold to the investor, such as its code, name and signature of the authorized representative will be checked by the counter against the manual and book circulated by the OTCEI.
and sent to the registrar for validation.

4 copies of sale confirmation slip (SCS) will be prepared simultaneously, one each for the investor, the counter OTCEI and the custodial/registrar.

At the end of each day, copies of all the CRS and SCS, issued by each counter along with a consolidated statement showing company-wise transactions will be sent by each counter to the OTCEI.

The counters may wish to retain the Transfer Deeds (TDS) filled in by sellers and not transfer the scrips in their name and send them to the custodian/registrar for updating.

When the counters want to transfer the shares in their name, they will send the copy of the relevant SCS also along with the TDS to the custodian/registrar. But, the copy of SCS should be sent to the OTCEI on the same day of the transaction. If any scrips were sold back, their TD (with the new investor's particular on the purchase) along with the copy of SCS and the CR (when the scrip was sold to a new investor) will be sent to the custodian/registrar. The actual activities of buying and selling are described in Exhibit 2.5.
The establishment of the OTCEI is a bold new step in the development of the Indian capital market. When its decentralized counters are linked by electronic communication systems, it would be possible to address several problems of investors and issuers so that the OTCEI could truly rise to a status where it can be called the stock exchange of the 21st century.
Future plans of the OTCEI include:

a) Increasing the dealer network country-wide.

b) Proposals to allow 'options' trading on the OTCEI.


d) Automated banking.

The OTCEI is a new concept in stock trading in India. Its success will largely depend on the response it gets from the companies and investing public. Table 2.5 reveals the turnover of the Over The Counter Exchange month-wise.
### TABLE 2.5

**TURNOVER DATA**

**OTC EXCHANGE SEPTEMBER-92 TO MARCH 31ST 1995**

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<th>Month</th>
<th>Deals</th>
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<th>Volume Rs.</th>
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The number of listed companies on the Over The Counter Exchange of India touched the 100 mark level on 10th June, 1996. In addition, there are 13 listed debentures and the present market capitalisation of the listed securities of
both equity and debentures is Rs. 670 crores. (Source: The Times of India 12-6-'96).

2.8 NATIONAL STOCK EXCHANGE (NSE):

The genesis of the national stock exchange lies in the recommendation made in 1991 by the Pherwani Committee. The committee had found five lacunae in the Indian stock markets, namely lack of liquidity, lack of infrastructural facilities, an inefficient and out-dated trading system, and out-dated settlement system. Besides that it was also observed that the facilities were grossly inadequate to cater to the growing volumes of business.

NSE was thus set up to strengthen the move towards professionalism of the capital market as well as to provide nation-wide securities trading facilities to the investor. This could be viewed as an important step in upgrading trading facilities for investors and bringing Indian financial market in tune with international markets. NSE is a fully automated, screen-based trading system which has brought efficiency and transparency into the market.

For many reasons, the trading in corporate debt and government securities has not picked up in India as compared to the equity market. The NSE is now playing an effective role in providing infrastructure and trading facilities for developing an efficient secondary market for both debt and equity instruments.

NSE adopts the principle of an order-driven market and allows trading members to trade from their offices
through a communication network. The NSE trading system software named NEAT (National Exchange for Automated Trading) is a state-of-the-art software. All trading information is held in memory database to achieve minimum response time and maximum system availability for the users. The system generates an order confirmation slip, when an order is placed. Similarly, when some trading takes place, a confirmation slip is printed at the trading member's work station. The trade confirmation slip gives the volume traded, price at which the deal has been made and the counterparts with whom trade has taken place etc.

The tele-communication network is the backbone of the automated system. Each trading member trades on the NSE with the other members through a computer located at the trading members' office anywhere in India.

Promoter:

The promoters of the NSE are financial institutions like IDBI, IFCI and ICICI. Insurance corporations like LIC and GIC, commercial banks like the SBI, Bank of Baroda, Canara Bank, and others like SBI caps, and Stock Holding Corporation of India Ltd.

Listing requirements:

The companies should meet the following requirements for listing on the NSE:

a) A company should have a minimum paid up capital of Rs. 10 crore.

b) It should have a market capitalization of Rs. 50
c) All the listed companies should provide unabridged balance sheets to the shareholders of the company.

d) All the listed companies have to compare the actual financial performance with that of the projection made by them at the time of going public.

e) Once the depository is created, it is necessary for the companies to immobilize their share certificates.

Eligibility criteria for trading membership:

Different criteria are laid down for different market segments. These are given below separately.

For wholesale debt market segment:

1) Individuals, subsidiaries of banks and institutions are eligible for membership.

2) The whole-time directors or the dealers should possess at least two years experience in any activity related to banking or financial service.

3) The applicant must possess net worth of Rs 2 crores.

For capital market segments:

1) Individuals, registered firms, corporate bodies and institutions are eligible for membership.

2) The minimum net-worth requirements described are as follows:
   a) Individuals and registered firm : Rs 75 lakhs.
   b) Corporate bodies : Rs. 100 lakhs.

3) The minimum prescribed qualification is graduation and two years experience in dealing in capital market must
be fulfilled by:

a) Minimum two directors, in case the applicant is a corporate.

b) Minimum two partners, in case of partnership firm.

c) An individual, in case of individual or sole proprietorship concern.

Common to both the segments:

a) The applicants must be engaged solely in the business of securities and must not be engaged in any fund-based activities.

b) The minimum paid up capital for a corporate body should be Rs. 30 lakhs.

Benefits:

[a] To trading members:

1) Trading members can provide efficient service to clients.

2) Their back office load is reduced as the system generates details of trade undertaken.

3) The automated trading system ensures high growth in trading volumes.

4) Foreign institutional investors prefer the automated and regulated market which the NSE is providing.

[b] To investors:

1) Investors get the best price on the market.

2) On contract notes, the price and brokerage are separately shown.
3) Place and time of trade are indicated.
4) Settlement is quick and money/securities are received fast thereby enhancing equity.

[C] To issuers:
1) By a single listing, they can provide nation-wide access to their investors.
2) The listing cost is reduced.
3) Issues have a high visibility.

Wholesale debt market is a facility for institutions and bodies corporate to enter into high value transactions such as government securities, treasury bills, public sector bonds, unit 64 of UTI, commercial papers and certificates of deposit.

There are two types of functionaries operating at the NSE. They are known as trading members and participants.
1) Trading members:
They are the recognised members of the exchange. They are selected on the basis of comprehensive selection criteria laid down under the provisions of Securities and Exchange Board of India. They can trade on their own account or on behalf of their clients.

2) Participants:
Participants include trading members who settle trades executed on their own account and on behalf of those clients who are not direct participants. The participants have access to the NSE trading system which enables them to see the breadth and depth of the market through inquiry screens.
The identity of the trading members placing the order is not disclosed in the NSE computer trading system. It helps big players thereby to place large orders into the system without fear of influencing the price of those securities. The system provides complete transparency of trading operations. The investors can see prices of traded securities. They know the rate at which their deal has taken place.

Orders are matched automatically by the exchange computer system. All orders received are stocked in price—time priority. As soon as it finds a suitable match, the deal is struck. If it does not find the match immediately as may happen in the case of less liquid securities, the investors have to wait.

In line with automation of trading facilities, the post-trade facilities for clearing and settlement of trades are also automated. Confirmed trade executed on the NSE are processed further at the clearing house, where a participant's obligations for funds and securities would be drawn up each day and conveyed to the respective participants/settlers. The Stock Holding Corporation of India Ltd. [SHCIL] is the clearing and settling agency for the PSU bonds. In case of government securities and treasury bills, the SHCIL would do the clearing activity and settlement will be affected by the corresponding agency on behalf of the participants. Automated clearing, book entry transfer and a depository mechanism is envisaged for the
capital market segment.

2.9 BOLT:

The Bombay Stock Exchange On Line Trading System (BOLT) was conceptualized in 1989. A team of about seven senior officials from the BSE had visited the exchange centres in London, New York, Rio de Janeiro, Singapore, Tokyo, Hongkong and Malaysia. An indepth assessment of the trading and settlement systems was drawn out to develop a model for the Bombay Stock Exchange.

The BOLT system was introduced with the following objectives:

a) To insulate upcountry investors from getting raw deal from sub-brokers.
b) To provide more reliable and transplant service.
c) To save double brokerage.
d) To encourage healthy competition amongst brokers which would ultimately benefit the investors.
e) To minimize arbitrage possibilities.

Advantages of BOLT:

a) Transparency of transactions
b) Increase in trading volume
c) Lower transaction costs
d) Reduction in brokerage costs
e) Boost investments of FIIS
f) Reduce monopoly of the Jobbers
g) Advantage to the investor is that the Jobbing spreads have narrowed down.
The only disadvantage in heavy investment is computer networking.

The ultimate beneficiary of the whole exercise would be small investors. They might trade at the BSE without passing through a chain of intermediates.

Trading and Settlement in the Online System:

- Under the conventional system an investor, anywhere in the country, contacts a broker in Bombay and lets him know which scrips and how many he/she wants to buy or sell.
- The broker, in turn, contacts a Jobber.
- The Jobber goes to the trading ring and makes physical gestures, inviting buy or sell quotes.
- Anyone interested in buying or selling that particular scrip will come to the Jobber, and if the quote is acceptable, the order will be executed.
- The physical delivery of scrips takes place after a fortnight.
- Thus, the deal is to be settled within a fortnight, though in reality it may take more than a month.

However, under the new Online System, the procedure is very simple:

- An investor, anywhere in the country, contacts a broker in Bombay and tells him which scrips and how many he/she wants to buy or sell.
- The broker, in turn, contacts a Jobber.
- The broker/Jobber enters his buy/sell quotes into his
system which is connected to the main server at the BSE.

- Matches will then be made by the computer where Jobbers are given preference concerning quotes. This serves as an incentive to the Jobber who acts as a catalyst to the match-making process and renders liquidity to the scrip.

- Matches are recorded directly at the main computer.

- The settlement procedure remains the same.

Phases of computerisation of the BSE:

Computerisation of the BSE has taken place in several phases as discussed below:

Phase—1:

Display Information Driver System (DIDS)

This it was implemented in 1992. This phase essentially helped to educate the brokers about networking and sharing of data. The dissemination of price data and market news gathered manually was the main achievement during this phase.

Phase—2:

BSE Automated Settlement Data Exchange (BASE).

The second phase was introduced in 1994. It enabled the brokers to use the network that was set up in the first phase and upload and download the data required for the purposes of settlement.
Phase —3 :

The third and the most significant phase is BOLT:

This phase was introduced in March 1995 offering screen-based trading for select scrips from the 'B' group.

Phase —4 :

It has been completed by the middle of 1995.

This phase has extended screen-based trading to 'A' group of shares as well.

Technology upgradation:

Technology upgradation on the BSE took place gradually. Firstly the PCs were installed at members' offices connected through telephone lines. The use of Data-Over-Voice (DOV) Multiplexer enabled simultaneous exchanges of data and voice on the same telephone line. Subsequently, the use of Microwave Radio Frequency Network provided the members anywhere in Bombay an access to the trading system. Finally, it is proposed to make use of satellite linkage to help members to trade on a nation-wide basis.

Future Plans:

The Bombay Stock Exchange may undergo a drastic organisational restructuring in the near future. The Board of Directors has already cleared the proposal in this regard. This is aimed at increasing the organisational efficacy and performance of the BSE. The proposed scheme is shown in the Exhibit - 2.6
EXHIBIT - 2.6

PROPOSED ORGANISATIONAL STRUCTURE OF BSE

The governing council will function through 14 committees:
1. Investment committee
2. Reception committee
3. Computer and technology development committee
4. Building and security committee
5. Seminar committee
6. Brokers consultative committee
7. Investors service committee
8. Scrutiny committee
9. Defaulters committee
10. Disciplinary action committee
11. Market Intelligence committee
12. Market operations committee
13. Market development committee
14. Organisation development committee

The governing council consists of 18 members and 1 executive director (ED). Of the 18, 9 are brokers and 9 are nominated members.

4. Functional Directors
   For day-to-day functions like listing, operations, surveillance, monitoring, secretarial, finance, audit, inspection, research and training. These functions are still to be allocated to each of the 4 new directors.

General Managers, Dep. General Managers
Managers, Asst. Manager (entry level)
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