CHAPTER II

AN OVERVIEW OF THE INDIAN STOCK MARKET

2.1 Introduction

The history, development, present position, trading practices and regulations pertaining to Indian stock exchanges have been narrated in this Chapter.

2.2 History and Development of the Indian Stock Market

Indian stock markets are one of the oldest in Asia. Its history dates back to nearly 200 years ago. The earliest records of security dealings in India are meagre and obscure. The East India Company was the dominant institution in those days and business in its loan securities used to be transacted towards the close of the eighteenth century.

The major sources of information pertaining to this Section
(a) _______ : The Stock Exchange Official Directory, various issues of Vol. 2 (9) (1), Bombay Stock Exchange, Bombay; and
2.2.1 Origin of the Stock Exchange in Bombay

At the end of the American Civil War, the brokers who thrived out of Civil War, in 1874, found a place in a street (now appropriately called as Dalal Street) where they could conveniently assemble and transact business. In 1887, they formally established in Bombay, the "Native Share and Stock Brokers' Association" (which is alternatively known as "The Stock Exchange"). In 1895, the Stock Exchange acquired a premise in the same street and it was inaugurated in 1899. Thus, the Stock Exchange at Bombay was consolidated.

2.2.2 The World Wars and the Indian Stock Exchanges

Indian cotton and jute textiles, steel, sugar, paper and flour mills and all companies, generally, enjoyed phenomenal prosperity, due to the two World Wars. It gave a sharp boom which was followed by a slump. But, in 1943, the situation changed radically, when India was fully mobilised as a supply base. On account of restrictive controls on cotton, bullion, seeds and other commodities, those dealing in them found the stock market as the only outlet for their activities. They were anxious to join the trade and their number was swelled by numerous others. Many new associations

\^Dalal means broker.
were constituted for the purpose and Stock Exchanges in all parts of the country were floated - The Uttar Pradesh Stock Exchange Limited in 1940, Nagpur Stock Exchange Limited in 1940, Hyderabad Stock Exchange Limited in 1944 and Delhi Stock and Share Brokers' Association Limited and the Delhi Stocks and Shares Exchange Limited in 1947.

2.2.3 Present Position of Indian Stock Market

Most of the exchanges suffered almost a total eclipse during depression. Lahore Exchange was closed during partition of the country and later migrated to Delhi and merged with Delhi Stock Exchange. Most of the other exchanges languished till 1957 when they applied to the Central Government for recognition under the Securities Contracts (Regulation) Act, 1956. Only Bombay, Calcutta, Madras, Ahmedabad, Delhi, Hyderabad and Indore, the well established exchanges, were recognised under the Act. Some of the members of the other Associations were required to be admitted by the recognised stock exchanges on a concessional basis, but acting on the principle of unitary control, all these pseudo stock exchanges were refused recognition by the Government of India and they thereupon ceased to function.

Table - 2.1 portrays the overall growth pattern of Indian stock markets since independence. It is quite evident from
# TABLE 2.1

## Growth Pattern Of Indian Stock Market

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No. of Stock Exchanges</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>14</td>
<td>20</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>No. of Listed Cos.</td>
<td>1125</td>
<td>1203</td>
<td>1599</td>
<td>1552</td>
<td>2265</td>
<td>4344</td>
<td>6229</td>
<td>6480</td>
</tr>
<tr>
<td>3</td>
<td>No. of Stock Issues of Listed Cos.</td>
<td>1506</td>
<td>2111</td>
<td>2838</td>
<td>3230</td>
<td>3697</td>
<td>6174</td>
<td>8967</td>
<td>9642</td>
</tr>
<tr>
<td>4</td>
<td>Capital of Listed Cos. (Cr.Rs.)</td>
<td>270</td>
<td>753</td>
<td>1812</td>
<td>2614</td>
<td>3973</td>
<td>9723</td>
<td>32041</td>
<td>40796</td>
</tr>
<tr>
<td>5</td>
<td>Market Value of Capital of Listed Cos. (Cr.Rs.)</td>
<td>971</td>
<td>1292</td>
<td>2675</td>
<td>3273</td>
<td>6750</td>
<td>25302</td>
<td>110279</td>
<td>354106</td>
</tr>
<tr>
<td>6</td>
<td>Capital per Listed Cos. (Lakh Rs.)</td>
<td>24</td>
<td>63</td>
<td>113</td>
<td>141</td>
<td>175</td>
<td>224</td>
<td>357</td>
<td>423</td>
</tr>
<tr>
<td>7</td>
<td>Market Value of Capital per Listed Cos. (Lakh Rs.)</td>
<td>86</td>
<td>107</td>
<td>167</td>
<td>177</td>
<td>298</td>
<td>582</td>
<td>1230</td>
<td>3673</td>
</tr>
<tr>
<td>8</td>
<td>Appreciated value of Capital per Listed Cos. (Lakh Rs.)</td>
<td>358</td>
<td>170</td>
<td>148</td>
<td>126</td>
<td>170</td>
<td>260</td>
<td>345</td>
<td>868</td>
</tr>
</tbody>
</table>

the Table that the Indian stock markets have not only grown just in number of exchanges, but also in number of listed companies and in capital of listed companies. The number of listed companies has increased by 476 per cent in 1992 over 1946 and by 15009 per cent in the case of capital of listed companies, for the same period, indicating a remarkable growth. However, the annual average growth rate of these are 3.88 per cent and 11.53 per cent, respectively. The appreciated value per capital per listed companies which is at Rs.358 lakhs in 1946, is less than Rs.170 lakhs for about four decades (1946 to 1985) has reached Rs.260 lakhs in 1985 and has touched a high of Rs.868 lakhs in 1992. The raise after 1985 is due to the favouring government policies towards capital market.

The amount of capital raised has increased from Rs.876 million in 1960 to Rs.57492 million in 1991-92, indicating an annual average growth rate of 13.97 per cent. It has to be noted that, greater reliance has been made towards debentures by Indian companies. The percentage of debenture financing to total has increased from 10.73 per cent in 1960 to 69.92 per cent in 1991-92 (vide Table - 2.2).
### Table 2.2

**Capital Raised By Indian Companies**

(amount in Rs. million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
<th>Preference</th>
<th>Debenture</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>704</td>
<td>78</td>
<td>94</td>
<td>876</td>
</tr>
<tr>
<td>1965</td>
<td>681</td>
<td>106</td>
<td>216</td>
<td>1003</td>
</tr>
<tr>
<td>1970</td>
<td>637</td>
<td>111</td>
<td>119</td>
<td>867</td>
</tr>
<tr>
<td>1971</td>
<td>348</td>
<td>6</td>
<td>43</td>
<td>459</td>
</tr>
<tr>
<td>1972</td>
<td>699</td>
<td>102</td>
<td>180</td>
<td>981</td>
</tr>
<tr>
<td>1973</td>
<td>918</td>
<td>68</td>
<td>149</td>
<td>1135</td>
</tr>
<tr>
<td>1974</td>
<td>1001</td>
<td>71</td>
<td>238</td>
<td>1310</td>
</tr>
<tr>
<td>1975</td>
<td>634</td>
<td>49</td>
<td>302</td>
<td>985</td>
</tr>
<tr>
<td>1976</td>
<td>553</td>
<td>77</td>
<td>406</td>
<td>1036</td>
</tr>
<tr>
<td>1977</td>
<td>764</td>
<td>18</td>
<td>291</td>
<td>1073</td>
</tr>
<tr>
<td>1978</td>
<td>588</td>
<td>44</td>
<td>171</td>
<td>803</td>
</tr>
<tr>
<td>1979</td>
<td>1010</td>
<td>75</td>
<td>333</td>
<td>1418</td>
</tr>
<tr>
<td>1980</td>
<td>909</td>
<td>21</td>
<td>1029</td>
<td>1959</td>
</tr>
<tr>
<td>1981</td>
<td>1693</td>
<td>14</td>
<td>1361</td>
<td>3068</td>
</tr>
<tr>
<td>1981-82</td>
<td>2431</td>
<td>27</td>
<td>3156</td>
<td>5614</td>
</tr>
<tr>
<td>1982-83</td>
<td>2587</td>
<td>23</td>
<td>4450</td>
<td>7060</td>
</tr>
<tr>
<td>1983-84</td>
<td>3816</td>
<td>17</td>
<td>4542</td>
<td>8375</td>
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<tr>
<td>1984-85</td>
<td>3629</td>
<td>1</td>
<td>6933</td>
<td>10563</td>
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<td>1985-86</td>
<td>8351</td>
<td>10</td>
<td>7982</td>
<td>16343</td>
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<td>1986-87</td>
<td>10295</td>
<td>--</td>
<td>17407</td>
<td>27702</td>
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<tr>
<td>1987-88</td>
<td>8100</td>
<td>--</td>
<td>6642</td>
<td>14742</td>
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<tr>
<td>1988-89</td>
<td>11500</td>
<td>79</td>
<td>24000</td>
<td>35500</td>
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<tr>
<td>1989-90</td>
<td>12188</td>
<td>131</td>
<td>52464</td>
<td>64731</td>
</tr>
<tr>
<td>1990-91</td>
<td>12857</td>
<td>15</td>
<td>29314</td>
<td>42302</td>
</tr>
<tr>
<td>1991-92</td>
<td>17278</td>
<td></td>
<td>40199</td>
<td>57492</td>
</tr>
<tr>
<td>1992-93*</td>
<td>--</td>
<td>--</td>
<td>--</td>
<td>180000</td>
</tr>
</tbody>
</table>

*Note: * Provisional

2.3 Regulation of Indian Stock Exchanges

From time to time, Government of India, to ensure proper functioning of stock exchanges towards their economic role in the financial system, has appointed Commissions and Committees to enquire into the working and efficacy of the rules governing the working of stock exchanges.

2.3.1 The Earliest Legislations: 1865-1947

The earliest legislation related to the Indian stock market was introduced by the Government of Bombay, which passed Act XXVIII of 1865 to deal with the situation arising out of the Share Mania of 1860-65 which followed the outbreak of the American Civil War. On the basis of the recommendation of the Atlay Stock Exchange Enquiry Committee, the Government of Bombay initiated special legislation for controlling stock exchanges - Bombay Securities Contracts Control Act, 1925. The Act empowered the Government to grant recognition to a stock exchange and to withdraw such recognition and the rules of a stock exchange could be made or amended subject to prior the Government approval.

3 Various issues of Bombay Stock Exchange Official Directory, Vol.2 (9) (ii) of the Bombay Stock Exchange, was the main source of information contained in this section. Other sources have been acknowledged, wherever utilised.
The Bombay Securities Contracts Control Act was rectified in a Bill drafted in 1939. The Bill was revived again in 1947 and it was passed into an Act in that year - The Bombay Forward Contracts Control Act, 1947.

2.3.2 Gorwala Committee, 1951

With the new Indian Constitution in 1950, stock exchanges and futures markets became exclusively a Central subject. In June 1951, the Government of India appointed an Expert Committee - Gorwala Committee - to assist the Government in formulating legislation for the regulation of stock exchanges and of contracts in securities.

2.3.3 Securities Contract (Regulation) Act, 1956

On the basis of the draft Bill recommended by Gorwala Committee, the Government passed the Securities Contract (Regulation) Act, 1956. The Act sets up a general framework of control to regulate stock market in India. Under the Act, only those stock exchanges which have been recognised by the Central Government are permitted to function. An exchange is recognised only after the Government is satisfied that its Rules and Bye-laws conform to the conditions prescribed for ensuring fair dealings and protection of investors. This Act, which is the first Act on stock market of Independent
India has formed the basis of all future regulations in the area of stock markets. In this regard, this Act is considered as the 'foundational Act'.

2.3.4 High Powered Patel Committee, 1985

After a lapse of three decades, Government of India set up a high-powered Patel Committee in May 1984 (the last one was Gorwala Committee in 1951) to make a comprehensive review of the stock exchanges and make recommendations.

On the basis of recommendations made by the Committee, Government issued several guidelines and directives to the stock exchanges relating to matters such as bringing down the cost of public issue of securities, listing of securities, creation of a Customer's Protection Fund and insurance cover for members of stock exchanges.

2.3.5 Dave Committee, 1987

Equity prices witnessed a downward movement during 1986-87, thanks to high cost of inputs and raw materials, rise in fiscal levies, poor infrastructural facilities and depressing features for the corporate sector in the 1986 and 1987 budgets. To arrest the bearish trend, the Government set up Dave Committee to examine the regulations and
restrictions on trading in specified shares, in 1987. The Committee suggested relaxation of the curbs in a phased manner. 4

2.3.6 Securities and Exchange Board of India (SEBI), 1988

One of the recommendations of the Gorwala Committee (1951) was the need for uniformity in the law and rules governing stock exchanges as well as in the administrative machinery for the enforcement of regulations. Also, the Patel Committee (1985) recognized the need for strengthening of stock exchanges and worked out a scheme for setting up of an apex body called 'Council for Securities Industry', which is not supposed to supplant the Stock Exchanges Division of the Ministry of Finance in its functions. 5

Thus, the burgeoning growth of the stock markets has


5 It has to be noted that the Patel Committee rejected the idea of a National Investment Commission on the lines of Securities and Exchange Commission in United States of America on two grounds: (a) Such a Commission may erode the autonomy of stock exchanges and thereby defeat the objectives of self-regulation on a uniform basis by the stock exchanges themselves; and (b) the Commission may not perhaps be a conducive agency for rapid development of stock exchanges and capital market (Maheswari, C.G. (1988), p.155).
inevitably resulted in the establishment of a separate watch-dog for the securities industry. Accordingly, in April 1988, the Government constituted Securities and Exchange Board of India (SEBI) as a non-statutory body to promote orderly and healthy development of the securities markets and to provide adequate investor protection. SEBI would seek to create an environment to facilitate mobilisation of adequate resources through the securities market. This environment includes rules and regulations, institutions and their inter-relationships, instruments, practices, infrastructure and policy framework. Thus, "SEBI is supposed to be an apex regulating authority helping to create self-regulatory organisations (SROS) for various segments of the capital markets. SROS will do the actual regulating, with SEBI merely overseeing their functioning."\(^6\)

"The capital market in India has witnessed tremendous growth in recent times, characterised particularly by the increasing participation of the public. Investor's confidence in the capital market can be sustained only by ensuring investor protection. With this end in view, Government has decided to vest SEBI with statutory powers required to deal effectively with all matters relating to the capital market." (Statement of Objects and Reasons as

stated in the Securities and Exchange Board of India Bill, 1992.) Thus, the Government passed Securities and Exchange Board of India Act, 1992, in January 1992, giving statutory powers to SEBI.

For a long time, SEBI's biggest handicap has been the SEBI Act, which only allowed it to recommend punishment against lawbreakers without being able to take action. This situation has been changed since 1993. The power to prosecute violators under Sections 56(3), 57, 58, 59, 73(2)(a) and (2)(b), 113(1) and 207 of the Companies Act, 1993, which protect investor's rights, were transferred from the Company Law Board to SEBI.

2.3.7 Expert Study, 1991

Along with the steps taken by the Government of India in stabilising SEBI's role in controlling capital market, it has also taken other steps in regulating trading in shares in stock exchanges. With this aim, in February 1991, the Government of India (Department of Economic Affairs, Ministry of Finance) asked the Society for Capital Market

Research and Development to undertake an 'Expert Study of Trading in Shares in the Stock Exchanges', which suggested recommendations on settlement period, margin system, market-making, management information system, and governing boards and management. 9

2.3.8 Pherwani Committee Report, 1991

Stock exchanges in India are housed in congested locations, and lack adequate space for members and a modern trading ring. Also they are unable to develop a debt market, due to shortage of space, and the apparent unwillingness of members to act as market makers. 10 In this context, the Government of India has appointed a high-powered study group on establishment of new stock exchanges, which is, otherwise, called as Pherwani Committee, which submitted its report in June 1991.

The Committee has, strongly, recommended that "a new stock exchange be promoted immediately at New Bombay as a 'Model Exchange' and to act as a 'National Stock Exchange'"


The NSE, which is more than just a gleam in the eye of the Government, based on Pherwani Committee's report, has given concrete shape by the Industrial Development Bank of India, the country's largest term-lending institution, and the National Stock Exchange of India Limited (NSEIL) was incorporated in November 1992.

2.3.0 Reforms in the Real Sectors: Narasimham Committee, 1991

At the beginning of this decade, major changes have been effected by the Government of India in the areas of industrial, trade and exchange rate policies. These changes are designed to correct the macro-economic imbalance and effect structural adjustment with the objective of bringing about a more competitive system and promoting efficiency in the real sectors of the economy. With increasing deregulation of industry and the emergence of more competitive conditions, the responsibilities devolving on the financial system in mobilising resources and allocating

11 Ibid., p.109.
them efficiently and responding flexibly to emerging situations would be much greater. An efficient and market oriented financial system could, thus, be regarded as a complement to market based decision making in the real sector. In this context, the Government appointed a Committee on the Financial System (generally known as Narasimham Committee) in August 1991 to study and make recommendations in the area of financial sector reform so as to ensure that the financial services industry operates on the basis of operational flexibility and functional autonomy with a view of enhancing efficiency, productivity and profitability. Narasimham Committee submitted its report in November 1991. Major recommendations related to capital market by the Committee are:

(a) The capital market should be substantially and speedily liberalised.

(b) Appropriate regulatory framework has to be created for the sound, orderly and competitive growth of mutual fund business, whether they be in the public, joint or private sector.

(c) Securities and Exchange Board of India (SEBI) should be involved in prior sanction of new capital issues in respect

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14 Ibid, pp. 118-121.
of companies whose scrips are listed on the stock exchange.
(d) SEBI should formulate a set of prudential guidelines to protect the interests of the investors.
(e) The capital market should gradually be opened up to foreign portfolio investments.
(f) Efforts should be initiated to improve the depth of the market by facilitating issue of new types of equities and innovative debt instruments.

2.3.10 Securities Scam and its Aftermath

On April 23, 1992, the curtain went up on what eventually turned out to be the country's biggest-ever scam - 'Securities Scam - 1992'. The term "securities scam" refers to the diversion of funds from the banking system to various stockbrokers in a series of transactions - preliminary government securities - during the period April 1991 to May 1992.

On April 28, 1992 equities on Bombay Stock Exchange (BSE) crashed pulling down the BSE Sensitive Index by 570 points, from 4467.32 on April 22, 1992 to 3896.90 on April 28, 1992

(1978-79 = 100), the biggest fall in any single session.\textsuperscript{17} (No trading took place in BSE in between April 22, 1992 and April 28, 1992 due to the agitation by brokers on compulsory registration issue with SEBI.) In less than two months after the scam news, the stock prices dropped by over 40 per cent, wiping out market value to the tune of Rs.100,000 crores.\textsuperscript{18}

2.3.10.1 Janakiraman Committee

The Reserve Bank of India (RBI) appointed a Committee on securities transactions (commonly known as Janakiraman Committee) on April 30, 1992 to look into the securities operations by commercial banks and foreign banks\textsuperscript{19} and to investigate into the possible irregularities in funds management by commercial banks and financial institutions and, in particular, in relation to their dealings in Government securities, public sector bonds and similar instruments.\textsuperscript{20}

The Committee through its various number of Reports

\textsuperscript{17}The Financial Express, April 29, 1992, p.1.
\textsuperscript{19}The Financial Express, May 1, 1992, pp.1 and 12.
recommended a wide ranging reforms, especially, with regard to prudential management and supervisory control. The following are the major recommendations of the Committee:  

(a) The Committee favoured restricting the practice of banks entering into ready forward deals with other banks to Government securities only.

(b) Banks should, also, be prohibited in other securities including public sector undertaking bonds, units and shares.

(c) The issue of bank receipts should be an exception rather than the rule. There must be a central depository for all securities in which a bank normally deals.

(d) Bank receipt rules formulated by Indian Banks Association should be strictly enforced.

(e) Only "approved" persons should be allowed to operate as bank brokers. This approval must be given by an independent authority, like RBI or SEBI.

(f) Banks should not be given general power to operate portfolio management services and similar schemes; but, should be specifically authorised to do so. And, all portfolio management services accounts must be subject to a separate audit by the banks' statutory auditors.

(g) Internal control system of banks relating to security

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transactions should be organised better, with outside professional help, if necessary.

(h) RBI should strengthen its organisation responsible for market intelligence.

2.3.10.2 Joint Parliamentary Committee (JPC)

The Lok Sabha, on August 6, 1992 constituted the Joint Parliamentary Committee (JPC), under the Chairmanship of Ram Niwas Mirdha, to inquire into the multi-crore bank scam, which rocked the country's banking system.

The JPC Chairman favoured drastic action against stock exchanges that played a crucial role in the multi-crore stock scam; and according to him, the stock exchanges which refused to be reformed have to be strictly monitored and regulated by strengthening the SEBI in a big way.\(^\text{22}\)

To sum up, the essence of a market is free trading; and regulation is needed to ensure that the market does not run wild, such regulations must be substantive, properly directed, and not merely geared towards a public relations

\(^{22}\)The Financial Express, December 23, 1993, p.1
exercise at a time when social morale is at such a low ebb. 23

24 Trading Pattern Of The Indian Stock Market

Trading in Indian stock exchanges are limited to listed securities of public limited companies. 24 They are broadly divided into two categories, namely, specified securities (forward list) and non-specified securities (cash list). Equity shares of dividend paying, growth-oriented companies with a paid-up capital of at least Rs.50 million and a market capitalisation of at least Rs.100 million and having more than 20,000 shareholders are, normally, put in the specified group and the balance in non-specified group. 25

Two types of transactions can be carried out on the Indian stock exchanges: (a) spot delivery transactions "for delivery and payment within the time or on the date stipulated when entering into the contract which shall not


24 Corporate securities are of two kinds: (a) that of private limited companies and (b) that of public limited companies. Private limited companies can not list their securities on Indian stock exchanges, since they have been prohibited under the Companies Act, 1956 to issue shares to the public.

be more than 14 days following the date of the contract'; and (b) forward transactions "delivery and payment can be extended by further period of 14 days each so that the overall period does not exceed 90 days from the date of the contract." The latter is permitted only in the case of specified shares. The brokers who carry over the outstanding pay carry over charges (contango or backwardation) which are usually determined by the rates of interest prevailing.

A member broker in an Indian stock exchange can act as an agent, buy and sell securities for his clients on a commission basis and also can act as a trader or dealer as a principal, buy and sell securities on his own account and risk, in contrast with the practice prevailing on New York and London Stock Exchanges, where a member can act as a jobber or a broker only.

The nature of trading on Indian stock exchanges are that of age old conventional style of face-to-face trading with bids

\[26\] Ibid.

\[27\] Ibid.
and offers being made by open outcry. However, there is a
great amount of effort to modernise the Indian stock
exchanges in the very recent times, through Display
Information Driver System (DIDS), Trade Support System,
Automated Trading System, Integrated Telephone Network and
PTI (Press Trust of India) Stock Scan Services.

28 Ibid. p. 29-30.