Chapter 3

OVERVIEW OF CAPITAL MARKET IN INDIA

3.1 Introduction
3.2 Structure of the capital market
3.2.1 Players in the market
3.3 Characteristics of capital market
3.4 Functions of capital market
3.5 Indian securities market before and after liberalization
3.6 Indian capital market - landmarks and developments
3.7 Recent trends in capital market
3.8 The relationship of the new issue market and stock exchange
3.9 Role of the new issue market
3.10 Developments in the new issue market
3.11 Mechanics of security trading in stock exchanges
3.12 Legal control of stock exchanges in India
3.13 Growth of stock exchanges in India
3.14 Conclusion
Chapter 3

OVERVIEW OF CAPITAL MARKET IN INDIA

3.1 Introduction

Capital Market is a wide term used to comprise all operations in the new issues and stock market. New issues made by the companies constitute the primary market, while trading in the existing securities relates to the secondary market. While one can only buy in the primary market, securities can be bought and sold in the secondary market. The term capital market encompasses all operations of F.I.s, Banks, etc. at the long-end of spectrum of maturities. The demand and supply for the long-term funds are reflected in the capital market which is a market for borrowing and lending of funds of more than one year.

The pace of economic development is conditioned, among other things, by the rate of long term investment and capital formation and capital formation is in turn conditioned by the mobilization, augmentation and canalization of investible funds. The capital market serves a very useful purpose by pooling the capital resources of the country and making them available to the enterprising investors. Well developed capital markets augment resources by attracting and lending funds on a global scale. The Euro-currency and Euro-bond markets are international finance markets in terms of both the supply and demand for funds.

The increase in the size of the industrial units and business corporations due to technological developments, economies of scale and other factors has created a situation wherein the capital at the disposal of one or few individuals is quite insufficient to meet the growing investment demands. A developed capital market can solve this problem of paucity of funds. An organized capital market can mobilize and pool together even the small and scattered savings and augment the availability of investible funds.
While the rapid growth of joint companies has been made possible to a large extent by the growth of capital markets, the growth of joint stock business has in its turn, encouraged the development of capital markets. A developed capital market provides a number of profitable investment opportunities for the small savers.

3.2 Structure of the Market

There are various sub-markets in the capital market in India. The structure has undergone vast changes in recent year. New instruments and new institutions have emerges on the scene.

The sub-markets are as follows.

a) Market for corporate securities- for new issues and old securities.

b) Market for Government securities-

c) Market for Debt instruments- debentures and bonds of private corporate sector, bonds of public sector undertaking, public financial institutions, etc.

d) Mutual fund schemes and UTI schemes, etc.

So far as the individual investors are concerned, the market for corporate securities and Mutual funds schemes are more relevant. They satisfy the requirements of investor, namely income, appreciation of capital, safety, liquidity and hedge against inflation. In respect of corporate securities, leaving aside new issues market, the structure of the secondary market has undergone some changes which are depicted in the table below:
Overview of capital market in India

Table 3.1
Secondary Market Structure

<table>
<thead>
<tr>
<th>Regular Stock Exchanges (21)</th>
<th>Over the Counter Exchange of India (1)</th>
<th>National Stock Exchange (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>For big companies with paid up capital above Rs. 5-10 crores- Trading ring and physical operations includes Principal exchanges like Mumbai, Kolkata, Delhi, etc. and regional exchanges like Cochin, Indore, etc. Computerized trading in all exchanges.</td>
<td>Computerized trading for smaller companies with paid up capital of Rs. 30 lakhs to Rs. 25 crores. No trading ring – started operations in Oct. 92. The upper limit is now removed.</td>
<td>Recognised in April 93 and started operations later, only in Govt. securities and money market instruments Equity Trading started in Nov. 1994.</td>
</tr>
</tbody>
</table>

Source: SEBI Handbook.

The Table 3.1 exhibits the structure of Indian Capital market. From the table it can be seen that the Indian capital market basically consists of regular stock exchanges (which are 21 in number), Over the Counter Exchange (OTCE) and the National Stock Exchange (NSE).

The model given below presents a vivid picture of the structure of the market.
Model 3.1
Broad Contours of Money Flows

MONEY
CASH + CREDIT

CREATED BY
R. B. I. CASH

CREATED BY
BANKS CREDIT

INCOME –
EXPENDITURE =
SAVINGS

FUTURE CLAIMS
ON MONEY

INVESTMENTS

PHYSICAL
ASSETS

FINANCIAL ASSETS - INSTRUMENTS

A. SHORT TERM – DDS, MTS, CHEQUES, ETC. CALL MONEY, T.Bs, C.Ps, ETC.

B. LONG TERM (CAPITAL MARKET) – SECURITIES SHARES, DEBENTURES, DEPOSITS, BORROWINGS, ETC.

PRIMARY MARKET

INSTRUMENTS
NEW ISSUES,
RIGHT BONDS ETC.

SECONDARY MARKET
OR STOCK MARKET
TRADING IN OLD SHARES
AND SECURITIES.

ASSETS TRADED
GOVT. SECURITIES,
CORPORATE SHARES,
DEBENTURES, UNITS,
ETC.
Model 3.1 given above clearly shows the flow of money. The model also shows that basically there are two constituents of the capital market viz., primary market and the secondary market.

3.2.1 Players in the market:-

The players in the New Issues market are many and the most important of them are the following:

1. Merchant bankers: Their functions and working are crucial to new issue market. They are the issue mangers, lead managers, co-managers and are responsible to the company and SEBI. They take all policy decisions for and behalf of the company regarding the new issues and coordinate the various agencies and give "Due Diligence" certificate to the SEBI regarding the true disclosures as required by law and SEBI guidelines.

2. Registrars: Their functions are next to merchant bankers in importance. They collect the applications for new issue, their cheques, stock invests, etc., classify and computerize them. They also make allotments in consultation with the regional stock exchange regarding norms in the event of oversubscription and before a public representative. They have to dispatch the letters of allotment, refund orders and share certificates within the time schedules stipulated under the Companies Act and observe the guidelines of SEBI and the Govt. and RBI. Besides they have also to satisfy the listing requirements and get them listed on one or more of the stock exchanges.

3. Collecting and coordinating bankers: Collecting and coordinating bankers may be the same or different. While the former collects the subscriptions in cash, cheques, stock invests, etc., the latter collects the information on subscriptions and coordinates the collection work and
monitors the same to the registrars and merchant bankers, who in turn keep the company informed.

4. Underwriters and brokers: Underwriters may be financial institutions, banks, mutual funds, brokers, etc., and undertake to mobilize the subscriptions up to some limits. Failing to secure subscriptions as agreed to, they have to make good the shortfalls by their own subscriptions. Brokers along with their network of sub-brokers market the new issues by their own circulars, sending the application forms and follow up recommendations.

5. Printers, advertising agencies, and mailing agencies are the other organizations involved in the new issues market operations.

6. Stock Market Intermediaries: The players in the market are the issuers of securities, namely companies, intermediaries like broker, sub-brokers, etc., and the investors who bring in their savings and funds into the market.

   The stock brokers are of various categories, namely-

1. Client brokers: doing simple brokering between buyers and sellers and earning only brokerage for their services from the clients.

2. Floor brokers: authorized clerks and sub-brokers who enter the floor and execute orders for the clients or for members, and also called trading brokers.

3. Jobbers: those members who are ready to buy and sell simultaneously in selected scrips, offering bid and offer rates for the brokers and sub-brokers on the trading floor and earning profit through the margin between buying and selling rates. This category includes Markey makers for some scrips.
4. Arbitrageurs: those who do inter market deals for a profit through differences in prices as between markets but in Kolkata and sell in Mumbai and vice versa.

5. Badla financiers: those members who finance carry forward deals in specified group (A Group) for a return in the form of interest, called badla rage. They lend money or shares for the brokers who are overbought or oversold respectively at the time of settlement.

3.3 Characteristics of Capital market

Capital market may be defined as a market for borrowing and lending long term capital funds required by business enterprises. Capital market is the market for financial assets that have long or indefinite maturity. Capital market offers an ideal source of external finance. Capital market forms an important core of a country's financial systems too.

Following are the characteristics features of the capital market.

a) Securities market-

The dealings in the capital market are done through the securities like shares, debentures, etc. The capital market is thus called securities market.

b) Security prices-

The price of securities that are dealt with in the capital market is determined through the general law of demand and supply. The equilibrium between demand and supply of securities is brought about by the prices. The price depends upon a large number of factors such as the following:

- Yield on securities.
- Extent of funds available from public savings.
- Level of demand for funds.
- Flow of funds from the banking system.
Overview of capital market in India

- Price situation in general.
- Attitude towards liquidity on the part of the investors.

c) Participants-

There are many players in the capital market. The participants constitute a plethora of institutions, which provide a wide variety of services of access to capital. The capital is either directly supplied or arranged through financial intermediaries. These intermediaries form the basic edifice of a capital market. The participants in the capital market include-

- Financial intermediaries like insurance companies, investment companies, pension funds, etc.
- Non-financial business enterprises.
- Ultimate economic units like households and governments.

d) Location-

It is interesting to note that the capital market is not confined to certain specific locations, although it is true that parts of the market are concentrated in certain well known centers known as stock exchanges. It exists all over the economy, wherever suppliers and users of capital get together and do business.

3.4 Functions of capital market

The functions that are performed by the capital market are detailed below:

a) Allocation function-

It also allocates and rations funds by a system of incentives and penalties. Capital market allows for the channelizing of the savings of the innumerable investors into various productive avenues of investments. Accordingly, the current savings for a period are allocated amongst the various users and uses. The market attracts new investors who are willing to make new funds available to business.
b) Liquidity function-
Capital market provides a mean whereby buyers and sellers can exchange securities at mutually satisfactory prices. This allow liquidity for the securities that are traded.

c) Other functions-
In addition to the funds allocation and liquidity, capital market also renders the following functions.

i. Indicative function-
A capital market acts as a barometer showing not only the progress of a company but also of the economy as a whole through share price movements.

ii. Savings and Investment function-
Capital market provides a means of quickly converting long term investment into liquid funds, thereby generating confidence among investors and speeding up the process of saving and investment.

iii. Transfer function-
Capital market facilitates the transfer of existing assets- tangible and intangible- among individual economic units or groups.

iv. Merger function-
Capital market encourages voluntary or coercive take-over mechanism to put the management of inefficient companies into more competent hands.

3.5 Indian securities market before and after liberalization

The features of the Indian securities market before liberalization are as follows.

a) Fragmented regulation and multiplicity of administration.

b) Primary markets were not in the main stream of financial system.
c) Poor disclosure in prospectus further prospectus, balance sheet was often not made available to the investors.
d) Investors faced problems of refund delays, transfer delays, etc.
e) Stock exchanges were regulated through Securities Contracts (Regulation) Act. No inspection of stock exchanges was undertaken.
f) Stock exchanges were run as ‘brokers’ clubs’ and the management was dominated by the brokers.
g) Merchant bankers and other intermediaries were unregulated.
h) There was no concept of capital adequacy.
i) Mutual funds were virtually unregulated with potential for conflicts of interest in structure.
j) There were poor disclosures by mutual funds, Net Asset Value was not published and there were no valuation norms.
k) Takeovers were regulated only through Listing Agreement between the stock exchange and the company.
l) There was no prohibition on insider trading and fraudulent and unfair trade practices.

The present process of economic reform, which began in the year 1991, has focused on increasing output, efficiency and competitiveness of Indian industry at home and abroad by pulling down artificial quantitative entry barriers for industry, removing restrictions on growth in size of firms and licensing requirements. The reform of the financial services sector, especially the securities market has been at the very heart of this effort, which has aimed at engendering a much larger role for the private corporate sector in the economy and at allocation of capital through market channels. Accordingly, the intention of the Government of India to set up a separate Board for the regulation and orderly functioning of the capital market was first declared in the Budget Speech
by Shri Rajiv Gandhi, the then prime Minister and Minister of Finance. While presenting the budget for the year 1987-88 he stated.

"The capital markets in India have shown tremendous growth in the last few years. Approvals of capital issues have exceeded Rs. 5000 crores in 1986-87. They were only about Rs. 500 crores in 1980-81. For a healthy growth of capital markets, investors’ rights must be fully protected. Trading malpractices must be prevented. Government have decided to set up a separate Board for the regulation and orderly functioning of stock exchange and the securities industry."

By a Notification issued on 12th April 1988 the Securities and Exchange Board of India (SEBI), was constituted as an interim administrative body to function under the overall administrative control of the Ministry of Finance of the Central Government.

Finally in the Budget Speech for 1992-93 the Finance Minister said.

"Financial sector reforms also include reform of the capital markets, which will increasingly play a vital role in mobilizing and allocating resources from the public. Several initiatives announced in my budget speech last year have since been implemented. The Securities and Exchange Board of India (SEBI), has now been established on a statutory basis. As we gain experience, additional powers will be given to SEBI to strengthen its capability."

Though India has long history of stock exchanges, the securities markets really emerged from the periphery into the main stream of the country’s financial sector.
3.6 Indian capital market - landmarks and developments

In the 1950s India's capital markets helped to mobilize financial resources for the corporate sector. The importance of these markets then diminished because subsidized credits were available from commercial and development banks, equities had to be issued at a discount substantially below market value, the capital market lacked liquidity and investor safeguards were inadequate. A reform of the Foreign Exchange Regulation Act in the early 1970s limited the expansion of foreign owned and foreign-controlled companies. In response, many companies decided to become Indian companies. This led to the issue of substantial quantities of company shares at low prices, the market's revival continued in the 1980s as various measures were introduced to stimulate both demand and supply. Incentives for equity and debenture issues included reducing the corporate rate of tax of listed companies and fixing the permitted interest rate for debentures above that of fixed deposits but below that for bank loans. The government also authorized the use of cumulative, convertible preference shares and equity linked debentures and gave generous fiscal incentives to investors.

The growth of the Indian capital markets has been impressive. Equity market capitalization on the Bombay Stock Exchange increased from $11.8 billion to $19.4 billion between the end of 1980 and 1987; average capitalization ratios remained roughly equal to 6.5 percent of increased from 2114 in 1981 to 6017 in 1987. New issues of debentures also multiplied. However, there were also abuses, such as the use of misleading prospectus and insider trading. In addition, the processing of new issues, which were heavily oversubscribed because of their lower prices, was plagued by delays in share allocation.

In April 1988 the Securities and Exchange Board of India was established to oversee and regulate the market. In August 1988 a credit
rating agency was established to grade capital issues. In January 1989 proposals were published regarding the appointment of market makers offering bid-and-asked quotations, the responsibility of stockbrokers for vetting companies before listing, the opening of stock broking to banks and other financial institutions, and the creation of a second-tier market for smaller enterprises, with less onerous listing requirements. The measures were intended to improve market liquidity and to provide adequate protection to investors. Some of the important developments and landmarks achieved by and in the capital market have been cited as under.

1. Amendment to Banking Regulation Act in 1983 permitting banks to undertake non-banking functions like merchant banks and Mutual funds who started operations in the Capital market through their subsidiaries.

2. Entry of Public sector banks through their Mutual funds in a big way since 1987 for channeling small saving into the Capital market.

3. Setting up of the SEBI by the Govt. in 1988 to observe capital market.

4. Establishment of SHCIL by All Indian Financial Institutions (FIs) and banks introducing a new concept to depository functions and bookkeeping for stock market dealings of the sponsoring institutions.

5. Setting of credit rating agencies, namely CRISIL, IICRA, CARE, etc. from 1988 onwards popularizing the credit rating function by Companies issuing debt instruments.


7. Issue of public sector bonds since 1985 and disinvestment of equity share to the public since 1991 by the P.S.Us.

8. SEBI got the legal status by the passing of the SEBI Act in April 1992.
9. Abolition of the CIC Act and the Controller of Capital Issues resulting in a free entry into the Capital market and free pricing of shares by the Companies since May 1992.

10. Offshore Funds are allowed to be floated by banks and FIs abroad from 1985 onwards.

11. Indian companies are allowed to raise capital abroad on commercial lines, from 1993 onwards.

12. FFIs and FIIs are allowed to operate in Indian capital market after registration with the SEBI (including the OCBs)

13. More liberal investment entry for NRIs and foreign investment in Indian companies allowed up to 51 percent after 1991 economic reforms.

14. Mutual funds are allowed to be set up in the private sector (1992-93) and a large number of them have already entered the fray.

15. National Stock Exchange was set up and recognized by Government of India in 1993 and started operations of trading in 1994.


17. Introduction of Futures and options trading on major Stock Exchanges.

18. Adoption of Rolling Settlement involving daily settlement of trades on compulsory basis.

3.7 Recent trends in capital market

A new era in capital markets in India was ushered in July, 1991, with the starting of a process of financial and economic deregulation. Beginning with the devaluation of rupee by about 20 percent in July 1991, industrial policy was totally reshaped to dispense with licensing of all industries except the 18 scheduled industrial groups. Further, removal of MRTP limit on assets of companies, dilution of FERA and foreign trade liberalization, etc., were some of the other reforms. Fiscal policy was
rationalized to reduce the Central Budget deficit and public sector undertakings were freed from government controls by professionalizing their managements, giving greater autonomy to them by disinvestment of their shares in favour of the public.

Greater role is visualized for the private sector in the future investment growth. Liberalization of controls and financial deregulation allowed freer role to the market force. The economy is expected to shift to a market-oriented competitive environment. Freer entry and exit to foreign financial and corporate units from abroad would encourage freer competition, cost effectiveness and improved productivity in the Indian economy. These would improve the growth of the economy, role of privat corporate sector and of the capital market. The dependence of the government, semi government bodies, P.S.U.s and of corporate sector on the capital market is bound to expand in the years to come. The potential of the Indian Capital Market to growth is vast.

The beginning of liberalized policies dates back to 1985 when the Seventh Five Year Plan was started. The Banking companies Amendment Act of 1983 gave new avenues of activist to bank in the form of participation in non-founded activities and financial services such as leasing, hire-purchase, merchant banking, etc. The public sector banks have started setting up subsidiaries for merchant banking; lease banking, mutual funds, etc., since that time. After 1992 even private sector is allowed to enter into these financial services, including banking, mutual funds, etc. By 1987, many public sector banks have set up Mutual Funds.

The SEBI was set up in April 1988 to oversee and control the capital market and it has been given legal powers since April 1992 by an Act. A number of new institutions like CRISIL for credit rating and SHCIL for clearance and share depository service have been set up. A new structures
Overview of capital market in India

securities market was initiated by setting up of an over the Counter Exchanges of India (OTCEI) for computerized trading of small and ill-traded companies. This Exchange was the 22nd Exchange to be given recognition under the SC(R) Act, in 1989.

3.8 The Relationship of the New Issue Market and Stock Exchange

The New Issue Market and Stock Exchange are inter-linked and work in conjunction with each other. They cannot be described as two separate markets because of the kink of functions they perform. Although they differ from each other in the sense that the New Issue Market deals with 'new securities' issued for the first time to the public and the stock exchange deals with those securities which have already been issued once to the public, they are complementary in nature because of this particular function. The 'new issues' first placed with the NIM have a regular and continuous purchase and sale in the stock exchange when secondary purchases have to be made by the investor. The NIM, therefore, functions as a 'direct' link between the companies which require a provision for funds and the investing public. The Stock Exchange provides capital to firms 'indirectly'. The transactions relating to purchase and sale of securities, while providing both liquidity and marketability, do not involve firms in the transfer of stocks from one person to another. The stock exchange is, thus, an important medium of transfer of resources for those shares which have already been issued. It also plays a role in the transfer of securities with the companies whose shares are being dealt with as the process of registration of shares must be conducted when they are transferred.

The second factor which makes the role of the NIM and Stock Exchange complementary to each other is the infrastructural facilities provided for the 'sale and purchase' of securities. The NIM does not have a
physical existence but the service as is provided in India is taken up entirely by the brokers and commercial banks. The New Issue Shares, in the private corporate sector, are subscribed to go through the application forms supplied by the brokers before the date of commencement of the issue. On the opening day of the issue, these forms can also be collected from the authorized banks. The authorized bankers also undertake the function of collection of forms and receiving the amount on application. The NIM thus does not have a physical from or existence, but there are agencies which provide the facilities which are conducive to the sale of the new issues.

The stock exchange unlike the New Issue Market provides all the facilities in the form of a market. It is a well established organization with professional brokers, financial literature, information about companies and the daily stock exchange lists are supplied for information to the investors. This is also a place where dealers of security meet regularly at an appointed time announced by the market. The Bombay Stock Exchange is well organized with proper electronic gadgets to receive information about stock prices from other parts of the country. It also gives the daily changes in prices of stocks.

Another related factor between the NIM and stock Exchange is the relative strength and public confidence in their joint participation in the sale, purchase and transfer of securities. In India, NIM and The Stock Exchange are connected to each other even at the time of the New Issue. The Usual practice by the firms issuing securities is to register themselves on a stock exchange by applying for listing of shares. Listing of shares provides the form with an added prestige and the investing publics are encouraged with this service. The advantage of listing on a recognized stock exchange is that it widens the market for the investor. It provides the investor with the facility of sale of his shares, thus offering him a 'market'
for immediate liquidity of funds. Secondly, the working of the stock exchange and NIM provides a greater protection for the investing public as the companies applying for stock exchange registration are bound by the statutory rules and regulations of the market.

Further, the securities market is closely connected to each other because of the sensitive nature of the movements of stock prices. Stock prices are to a great extent affected by environmental conditions such as political stability, economic and social conditions, industrial pattern, monetary and fiscal policies of the government. The long-term and short-term changes in these factors have an effect on the day-to-day changes in prices of stocks. The New Issue Market depends on the stock exchange to find out these price movements and the general economic outlook to forecast the climate for investing and the success of new issues floated in the NIM. Thus, the prices shares in the NIM are sensitive to changes in the stock market and act and react accordingly and in the same direction and the general outlook in the market will show a “downswing” in the trading activity of securities.

The resource mobilization through the primary market can be seen from the table given below.
Overview of capital market in India

Table 3.2
Resource mobilization through primary market

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Mode</th>
<th>Calendar Year</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2004</td>
<td>2005</td>
<td>2006</td>
<td>2007</td>
</tr>
<tr>
<td>1.</td>
<td>Debt</td>
<td>2,383</td>
<td>66</td>
<td>389</td>
<td>594</td>
</tr>
<tr>
<td>2.</td>
<td>Equity</td>
<td>33,475</td>
<td>30,325</td>
<td>32,672</td>
<td>58,722</td>
</tr>
<tr>
<td>3.</td>
<td>Private Placement</td>
<td>93,506</td>
<td>83,812</td>
<td>117,407</td>
<td>1,11,838*</td>
</tr>
<tr>
<td>4.</td>
<td>Euro Issues(ADR/GDR)</td>
<td>2,029</td>
<td>9,788</td>
<td>11,301</td>
<td>41,567</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>131,393</td>
<td>123,991</td>
<td>161,769</td>
<td>2,12,721</td>
</tr>
</tbody>
</table>


The primary capital market grew in 2006 and 2007 after the set back of 2005. Table 3.2 clearly shows that the amounts raised and the number of new issues which entered the market increased in 2007. The total amount of capital raised through different market instruments during 2007 was 31.5 per cent higher than during 2006, which itself had seen a rebound of 30.6 per cent over the lows of 2005.

3.9 Role of the New Issue Market

The New Issue Market or Primary Market has three functions to perform. These may be put together and referred to as the ‘performing’ role of the NIM. These functions as described by Briston are (a) Origination, (b) Underwriting and (c) Distribution. The interplay of these functions helps to transfer resources from the sources of surplus funds to those who require these funds, i.e. the ultimate users of these funds.
Overview of capital market in India

**Origination**

Origination is the work which begins before an issue is actually floated in the market. It is the stage where initial 'spade work' is conducted to find out the investment climate and to be sure that if the issue is floated, it will be subscribed to by the public. The factors which have to be carefully analyzed are regarding the soundness of the project. Soundness of the project refers to its technical feasibility backed by its economic and financial viability. It is also concerned with background factors which facilitate the success of an issue. The underlying conditions are:

(a) The Time of Floating of an Issue: This determines the mood of the investment market. Timing is crucial because it has a reflection on the subscription of an issue. Periods of Buoyancy (PoB) will clearly show over-subscription to even ordinary quality issues and are marked by the general lack of public support during depression.

(b) Type of Issue: This refers to the kind of securities to be issued whether equity, preference, debentures or convertible securities. These have significance with the existing trends in the investment market. Sometimes, there is a sudden spurt of new issue of shares marked with government support and tax incentive. Investors are keen buyers of such an issue. The success of one encourages issues of these kinds to be floated. In these times, the market will have little support from even sound and good issues of these kinds to be floated. In these times, the market will have little support from even sound and good issues of other types of securities. The kind of marketability of the issue is an important analysis at the time of origination.

(c) Price: The encouragement of the public to a particular issue will largely depend on the price of an issue. Well established firms of some group connections may be able to sell their shares at a premium at the time of
a new issue, but relatively unknown firms will have to be cautious of the price. Price of shares of these firms should be fixed at par. There is a danger of fixing prices at a discount as these may undervalue the firm and bring down their reputation.

The functions of the NIM at the time of origination are, therefore, based on preliminary investigation and are mainly advisory in nature. Since 1981, the function of origination has been taken over in India by certain specialized divisions of commercial banks. Commercial banks have created a special cell called the ‘merchant banking’ division through which they advise the companies about the viability of the project. Merchant Banking was first started in 1969 in India by Grindlays Bank. They took the entire function of working out the necessary inputs and details for floating an issue including the function of origination of only those firms in whom they believed that success could be achieved. The Merchant Banking Divisions of Commercial Banks in India do not undertake to achieve the success of floatation of an issue. This division began its operations with the view of helping ‘new’ and ‘small’ issues and those units which are useful for the economic development of the country. They do not help out only superior firms but try to conduct their services towards the less superior firms also. The impact of the Merchant Banking Division of the banks is slowly being felt in the market for industrial securities. Origination coupled with the function of underwriting ensures success of an issue.

Underwriting is a kind of guarantee undertaken by an institution or firm of brokers ensuring the marketability of an issue. It is a method whereby the guarantor makes a promise to the stock issuing company that he would purchase a certain specifies number of shares in the event of their not being invested by the public. Subscription is thus guaranteed even if the public does not purchase the shares for a commission from the issuing
company. These are: (a) Life Insurance Corporation of India (LIC), (b) Unit Trust of India (UTI), (c) Development Banks like Industrial Development Bank of India, Industrial Finance Corporation of India, Industrial Credit and Investment Corporation of India (ICICI), (d) General Insurance Companies, (e) Commercial Banks and (f) Brokers. The methods adopted by these groups and their pattern of underwriting show a definite type of institutional role.

LIC and UTI both have emerged as the most important institutional underwriters in the capital market in India. Their underwriting pattern is marked by the policy of the underwriting firm, i.e. purchasing industrial securities from the new issue market with the view of holding the securities on their own portfolio. Both the institutions show a market preference for underwriting shares in large and well established firms and those belonging to established industrial centers like Maharashtra, Gujarat, West Bengal and Tamil Nadu. Their pattern was marked by the absence of underwriting in 'small' and 'new' enterprises. Since 1980, Life Insurance Corporation has withdrawn to a great extent from the sphere of underwriting. Unit Trust of India has become the most dominating underwriter in the NIM.

The pattern of underwriting of Development Banks is somewhat different to the institutional investors like LIC and UTI. They are gap fillers and are looked upon as engines of economic development while they also underwrite ‘firms’, they have given special attention to the growth of issues in backward states and those industries which are useful for the development of the economic status as the country, or those industries which fall in the priority list. The thrust of the Development Banks is also towards encouragement of small and new issues which do not have adequate support from other institutions.
The Development Banks of the nature of state orientation that is, the State Financial Corporations underwrite issues which are floated in the state of their origin. Their aim is to underwrite that issue which will contribute to the industrialization of their own state. The General Insurance Companies are bound by Section 27B of the Insurance Act of 1938. The Act directs them to make investments in a particular manner. Although their investment policy resembles LIC to a great extent, yet their underwriting pattern shows certain differences in approach. General Insurance Companies have, unlike the LIC, underwritten in companies which are fairly ‘new’ and are not established in the industrial sector. They have also not shown preference to ‘group’ issues of well-known family industrial housed. Their contribution in small issues can also be identified.

The Commercial Banks, to a great extent, have remained away from the underwriting sphere. They are better known for their function as agents engaged in the distribution of shares for a commission. Even if they have underwritten issues, it has been on an ad-hoc basis. They have not believed in an underwriting firm. They may keep the shares in their own portfolio or off-load them in the stock market for a price. They, therefore, do not have a particular direction in underwriting. They are also known to underwrite small amounts only.

The brokers do not underwrite a ‘firm’. They guarantee shares only with view of earning commission from the company floating its shares. They are known to off-load their shares later again to make a profit. The broker’s policy can thus be identified with the ‘profit motive’ in underwriting industrial securities. The New Issue Market has a third function besides the function of origination and underwriting. The third function is that of distribution of shares. Distribution means the function of sale of shares and debentures to the investors. This is performed by brokers.
Overview of capital market in India

and agents. They maintain regular lists of clients and directly contact them for purchase and sale of securities.

3.10 Developments in the New issue Market

The New Issue Market (NIM) has emerged as an important source of corporate financing in India after 1985. It was being regulated by Controller of Capital Issues in 1992. It was abolished and the Securities and Exchange Board of India (SEBI) was established for providing protection to investors and toning up the operations the NIM. It was also given the responsibility of the development and regulation of the NIM. The SEBI was to cover all the activities of the NIM, beginning with the planning of the capital issues and completing the formalities until the post issue activities. One of the developments in the NIM was the role of intermediaries in selling ‘new issues’. The role of the merchant bankers was considered complementary to the NIM as they carry out all the activities relating to the issue of shares. They draft the prospectus; appoint registrars for share application and transfers, provide arrangements for underwriting, select broker, bankers to the issues and handle past issue problems. SEBI has made it mandatory for all firms issuing shares to appoint merchant bankers. Merchant bankers must be regulated with the SEBI and is granted recognition on the basis of its capital adequacy norms in terms of its net worth. A merchant banker has to pay a registration fee annually. There are four categories of merchant bankers:

Category I holds responsibility to carry out activities relating to issue management, has to pay fees of Rs. 2.5 lakhs for the first two years and Rs. 1.5 lakhs for the third year. Category II merchant bankers were to pay Rs. 1,50,000 for the first two years and 50,000 for the third year. Merchant bankers were to act as advisors, consultants, portfolio managers,
underwriters or managers. Those in Category III were to act as advisor, underwriter and consultant. Category IV acts only as advisors or consultants to the issue. Therefore, merchant bankers in Category I are lead managers to an issue.

A merchant banker has to abide by the code of conduct laid down by SEBI. They have to submit documents and records and other legal papers under the guidelines of the SEBI. A lead manager has to prepare prospectus and submit it to the SEBI at least two weeks before the issue. The numbers of lead managers are related to the size of the issue. Two lead managers are appointed for an issue of less than Rs. 50 crores. Rs. 50-100 crores issue requires three lead managers and for Rs. 100-200 crore, four lead managers may be appointed.

Since 1995, another change in the NIM is with respect to intermediaries in the role of underwriters. Underwriting is no longer mandatory. They should have a certificate of registration with SEBI and are governed by its rules and regulations. He has to abide by a code of conduct. The third intermediary is the banker to the issue. He has to be registered with SEBI and has to pay fees of Rs. 2.5 lakhs for the first two years and Rs. 1 lakhs for the third year. He has also to abide by the code of conduct laid down by SEBI. Another intermediary, i.e. Brokers to the issue, is extremely important in the stock market but it is not compulsory in the NIM. An important activity in NIM which has been carried on after 1985 is to appoint registrars and share transfer agents to an issue. The role of the registrars is extremely useful. They keep a record of the investor and assist companies for allotment of securities. They dispatch allotment letters, refund orders, certificates and other documents relating to the issue of capital. The transfer agents maintain records of holders of security and deal with transfers and redemptions of securities. In Category I are placed those who are both
registrars and transfer agents and in Category II, are those who are either
transfer agents or registrars. They must be compulsorily registered with
SEBI and the capital adequacy requirement in Rs. 6 lakhs for Category I and
3 lakhs for Category II respectively. They also have to maintain a code of
conduct and act within the legal jurisdiction of the SEBI. A debenture
trustee is also a necessary intermediary in the NIM. He has to be registered
with SEBI. Only scheduled commercial banks, public financial institutions,
insurance companies and companies are entitled to act as debenture trustees.
The registration fees for a debenture trustee are Rs. 2 lakhs for the first two
years and 1 lakhs for the third year. The role of the debenture trustee is to
look after the trust property and carry out all the activities for the protection
of the debenture holders. Since the work requires integrity and fairness in
discharging their duties, SEBI has a code of conduct for debenture trustees
within which they have to carry out their duties.

The intermediaries have thus to follow a code of conduct, should
fulfill capital adequacy norms and be disciplined in their dealing in the
NIM. In case they do not follow the SEBI guidelines, their registration can
be cancelled and they may be penalized also.

The SEBI has also made certain procedural changes in the mode
of issue of capital for removing deficiencies in the issue procedure. Those
companies which intend to issue capital have been classified into existing
listed companies, existing unlisted companies and new companies. These
are divided into eight categories. These are.

Category A: This category consists of new companies with less
than 12 months in operation. At least 25 percent and 20 percent of total
issued capital of Rs. 100 crore and above Rs 100 crore respectively should
be through promoters like friends, relatives and associates. Then first public
issue must be made at par.
Category B: In this category are those companies which have a good record of making profits for the last five years and are making their first public issue. They are free to price their issue at par or premium.

Category C: Consists of private, closely held and unlisted companies which are making their first public issue. Such companies have a good past record of profits in at least three out of five years. It can issue shares at a premium but it must provide justification to the SEBI.

Category D: Is of private, closely held and unlisted companies without a consistent record of past profitability.

Category E: Consists of the same group of companies without a consistent past record of profitability but supported by existing companies with a consistent record of profitability in the last five years.

Category F: Is of existing listed companies that are making a public issue.

Category G: Existing companies- private, closely held and unlisted without a record of profitability by offering securities to the public without issue of fresh capital. They can make their issue only at par.

Category H: Existed companies- private, closely held and unlisted without a record of profitability by offering securities to the public without issue of fresh capital. They can make their issue only at par.

The contribution of the promoters in the public issue has to compulsorily be made before the opening of the public issue. However, where companies are issuing shares of above Rs. 100 crore, 50 percent are to be made before the opening of the issue and the balance is to be collected before the calls made. After receiving the contribution of the promoters, the company has to file a copy of the amount received from the promoters with the SEBI. The promoters' contribution has a lock in period during which
they are not transferable. These shares can be used as security with banks on loans granted by them.

The minimum offer made to the public should be 25 percent of each type of securities. The limit may be relaxed in the case of development financial institutions and government companies. The balance of 75 percent may be allotted to different categories of people and includes the promoters’ contribution and reservations with it. Investors under the firm allotment category cannot apply in the general category. Firm allotment may be given specifically under SEBI guidelines. The share of Indian mutual funds is up to 20 percent employees including working directors and 10 percent foreign institutional investors and non-resident Indians.

The application for shares is also made in accordance with SEBI guidelines. The minimum application money paid is 25 percent of the issue price. If the face value is Rs. 10, a minimum of Rs. 2.50 should be paid at the time of application of share. There should be a minimum of 30 collection centers at which money can be collected. The collection agents are authorized to collect application money be cheques or drafts but not is cash. The application money so collected should be deposited in the share application account with the authorized banker. If money receives 90 percent of the amount issued within 120 days of opening of the issue, it will be a valid issue and within 45 days of the closing of issue, a report signed by the chartered accountant must be sent to SEBI. If the issue is oversubscribed, proportionate allotment is to be made to all the investor. If the minimum subscription amount of 90 percent of the issue amount is not received by the company within 120 days of the opening of the issue, the subscription money must be returned to the investor. Before the public issue is made, it is mandatory that a prospectus is filled by the lead managers to SEBI. Although it is not compulsory to make an appraisal of a project, it is
Overview of capital market in India

quite useful to do so for purposes of term loans and underwriting of capital issues. In their own interest, whether SEBI makes it mandatory or not, a company can have its project appraised. However, SEBI has issued guidelines regarding the code of 'advertisement' for the issue of share. The statements in these advertisements should be clear and fair and not misleading and false. SEBI has also issued guidelines for bonus issues and right issues and debentures. A new development in the NIM relates to 'Bought Out deals' in sale of securities. Bought Out deals involve the promotion, sponsors and investors. It is an outright sale of large amount of equity to one single sponsor by an unlisted company. The price settled for purchase of those shares depends on negotiations and project evaluation and the price is competitive. The shares can be treated at the OTCEI or any recognized stock exchange to help the company to get listed. This is a specific activity of a merchant banker. The main difference between the deals and private n placement are dealings of listed companies.

The New Issue Market continued to make changes for improvements and toning up the quality of work in the market. SEBI appointed the Malegam Committee in 1995 to offer guidance in respect of disclosures made by companies to SEBI in respect of documents such as prospectus, financial information through the annual balance sheet and accounts and information to be given to SEBI on different issues from time to time. The Malegam Committee has suggested requirements on disclosures in documents of a company. This has come into effect since October 1, 1995. They cover all aspects such as prospectus, advertisements, new issues and right issues, pricing of shares, issue of shares at a premium, pure rigging and mergers.
3.11 Mechanics of security trading in stock exchanges

An investor must have some knowledge of how the securities markets operate. The marketing of old or new securities on the stock markets can be done only through members of the Stock Exchange. These members are either individuals or partnership firms. An individual must use the facilities of these members for trading in securities unless he himself is a registered dealer or member of organized stock exchange. Trading among members of a recognized stock exchange is to be done under the statutory regulations of the stock exchange. The members carrying on business are known as ‘brokers’ and can trade only on listed securities. These members execute customers’ orders to buy and sell on the exchange and their firms receive negotiated commissions on those transactions. About one-fourth of all members of the stock exchange are ‘specialists’, so called because they specialize in ‘making a market’ for one or more particular kind of stock.

In the process of trading in stock exchanges, there is the basic need for a ‘transaction’ between an individual and the broker. A transaction to buy and sell securities is also called ‘traders’. This is to be done through the selection of a broker.

It is useful to know that three kinds of securities can be traded upon in the Bombay Stock Exchange- specified, non-specified and odd lot. In the specified category of equity shares, the criteria are that the share should be listed on the stock exchange for at least three years and the issued capital should not be less than Rs. 75 crore. It should have a market capitalization of two or three times. At least 20,000 shareholders should be on the dividend receiving list. It should be a growth company with shares of Rs. 4.5 crore face value and its shares should be actively traded on the Bombay Stock Exchange. The companies which do not have specified securities are in the non-specified securities list. The odd lot includes shares
Overview of capital market in India

and debentures. In India, specified securities are fewer in number compared to other securities but they influence the stock market. To stabilize the market, limits have been imposed. When the stock market is on the rise being bullish or when it is bearish, limits on brokers and jobbers help in keeping the market firm and stabilized. In normal periods of time, the total outstanding purchasing and sales which can be made at one point of time is Rs. 5 crore. If these have to be carried forward, the limit is Rs. 3 crore. A broker’s carry forward business should not exceed one-fourth of his daily transaction. 75 percent of his daily transaction should be in cash. This system is called the “thin track” system whereby SEBI keeps a strict vigil on brokers dealings in the stock market. A capital adequacy norm has also been suggested for individual brokers. These reforms have been brought about after recommendations were made by the G.S.Patel Committee in 1995. SEBI was set up to regulate the organization and working of the stock exchanges and members operating within it. SEBI has brought about uniformity in the different stock exchanges. Nine stock exchanges were given permanent recognition. Others were to renew their licenses every year until they received a permanent recognition. Every stock exchange is to be managed by a committee called a governing board, consisting of brokers, directors, government, SEBI and public representatives.

1. Finding a Broker:-

The selection of a broker depends largely on the kind of services rendered by a particular broker as well as upon the kind of transaction that a person wishes to undertake. An individual usually prefers to select a broker who can render the following services.

(a) Provide Information: A broker to be selected should be able to give information about the available investments. These may be in the form of capital structure of companies’ earnings, dividend policies and
Overview of capital market in India

prospects. These could also take the form of advice about taxes, portfolio planning and investment management.

(b) Availability of Investment Literature: Secondly, a broker should be able to supply financial periodicals, prospectuses and reports. He should also prepare and analyze valuable advisory literature to educate the investor.

(c) Appoint Competent Representatives: Brokers should have registered competent representatives who can assist customers with most of their problems. In other works, to personalize brokerage business so that the customers need not have to look for their broker, the broker should be able to give the services at the residence or office of the investor.

The investor who is satisfied with the qualities of the broker will have to look next for a specialized broker. The second process is to find a good, reputed and established broker in the kind of deal that the investor is interested. In India, the stock exchange rules, by-laws and regulations do not prescribe any functional distinction between the members. However, brokers do establish themselves and are known for their specialization. In India, the following specialists can be contacted for trading in the ‘Securities’ market.

2. Kinds of Brokers – Selection:-

(a) Commission Broker: All brokers buy and sell securities for earning a commission. From the investor’s point of view, he is the most important member of the exchange because his main function and responsibility is to buy and sell stock for his customers. He acts as an agent for his customer and earns a commission for the service performed. He is not allowed to deal with the non-members. He can either deal with a broker or another jobber.

(b) Jobber: A Jobber is a professional speculator. He works for a profit called ‘turn’.
(c) Floor Broker: The floor broker buys and sells shares for other brokers on the floor of the exchange. He is an individual member, owns his own seat and receives commissions on the orders he executes. He helps other brokers when they are busy and as compensation, receives a portion of the brokerage charged by the commission agent to his customer.

(d) Taraniwalla: The Taraniwalla is also called a jobber. He makes an orderly and continuous auction in the market in the stock in which he specializes. He is a localized dealer and often handles transactions on a commission basis for other brokers who are acting for their customers. He trades in the market even for small differences in prices and helps to maintain liquidity in the stock exchange.

(e) Odd Lot Dealer: The standard trading unit for listed stocks I designated as a round lot which is usually a hundred shares. Anything less than the round lot is an odd lot which is traded on the floor of the exchange because odd lots appear in odd quantities- 8 shares, 10 shares or 15, 20, 25, 27, 33 and it is impossible to match buying and selling orders in them. The specialists handle odd lots. They buy odd lots which other members wish to sell for their customers and sell odd lots which others wish to buy. If dealers buy more than they sell or sell more than they buy, they can clear their position by engaging in round lot transactions. The price of the odd lot is determined by the round lot transactions. The odd lot dealer earns his profit on the difference between the price at which he buys and sells the securities. He does not rely on commission.

(f) Budliwalla: The financer in the stock exchange is also called the Budliwalla. For giving credit facilities to the market, he charges a fee called ‘contango’ or ‘backwardation’ charge. The Budliwalla gives a fully secured loan for a short period of two to three weeks. This loan is governed according to the prevailing rate of interest in the market. The
Budliwalla's technique of lending is to take up delivery on the due date at the end of the clearing to those who wish to carry over their sales. These transactions help him to make a profit on the prevailing rates of interest, subject to regulations of the stock exchange.

(g) Arbitrageur: An arbitrageur is a specialist in dealing with securities in different stock exchange centers at the same time. He makes a profit by the differences in prices prevailing in different centers of market activity. He maintains an office with a good communication system and telephonic and tele-printer facility. His profit depends on the ability to get the prices from different centers before others trading in the stock exchange.

(h) Security Dealers: The purchase and sale of government securities is carried on the stock exchange by Security Dealers. Each transaction of purchase or sale has to be separately negotiated. Dealer takes risk in ready purchase and sale of securities for current requirements. The Dealer has information about several kinds of government securities as well as statutory public bodies, but the presence of large investors like the Life Insurance Corporation (LIC) and commercial banks makes his role rather restricted.

3. Opening an Account with Broker:-

After a broker has been selected, the investor has to place an 'order' on the broker. The broker will open an account in the name of the investor in his books. He will also ask the investor for a small sum of money called margin money as advance. In case, the investor wishes to sell his securities, he will have to deposit with the broker share certificates and transfer deals. He will also have to sign in the transferor's column on the transfer deed. The physical presence of share certificates is not required anyone in India if shares have been through the 'demat' process.
Opening an account with the broker can also be optional on the part of the broker. Usually, the broker also satisfies himself that the prospective investor has a good credit rating that he will actually pay for the stock that he orders for purchase and that he is in a financial position to invest in securities. The broker may ask for bank reference and two or three credit references from the investor. He may also enquire from his customer, whether he is interested instability of principle, liberal dividend income, growth issues or speculative issues. Knowledge of the type of securities the customer is seeking and the degree market risk he is willing to assume will help the broker in knowing the customer’s requirements in the stock market. When the broker is satisfied about the customer’s intention to trade in the market, the broker and the investor reach to an agreement. The broker then writes the name of the customer in his books and opens an account. The next step for the investor is to place an order on the broker.

4. Order:-

Brokers receive a number of different types of buying and selling orders from their customers. Brokerage orders vary as to the price at which the order may be filled, the time for which the order is valid, and contingencies which affect the order. The customer’s specifications are strictly followed. The broker is responsible for getting the best price for his customer at the time the order is placed. The price is established independently by brokers on an auction basis and not by officials of the exchange. The following transactions take place on orders in the stock exchange.

5. Exercising Choice of Orders:-
(a) Long, Short, Spot Delivery, Hand Delivery, Special Delivery: When an investor buys securities, he is said to be ‘long’ in the issue, if he sells securities, he eliminates his long position, and when he strongly believes
that an issue is overpriced and will in most likelihood fall short within the foreseeable future, he may ask his broker to sell 'short'. A short sale involves selling an issue that one does not own and must borrow to settle the account, or does possess but does not wish to deliver. Financial institutions are not allowed to sell short. In short sales, the broker buys securities for his customer to make delivery but expects the seller to buy back at a later date in order to repay the borrowed share certificate. Short selling is the legal and the most obvious reasons for buying short is to cover stock in declining pricing.

(b) Spot Delivery: Spot delivery means delivery and payment on the same day as the date of the contract or on the next day.

(c) Hand Delivery: Hand delivery is the transaction involving delivery and payment within the time of the contract or on the date stipulated when entering into the bargain, which time or date is usually not more than 14 days following the date of the contract.

(d) Special Delivery: Special delivery is the delivery and payment exceeding 14 days following the date of the contract as specified when entering into a bargain, with the specific permission of the President or Governing Board. These transactions are conducted at the time of executing an order. The type of orders that can be made by the broker for his customer are described below:

(i) Market Orders: Market orders are instructions to a broker to buy or sell at the best price immediately available. Market orders are commonly used when trading in active stocks or when a desire to buy or sell is urgent. With this order, a broker is to obtain the best price he can for his customer- that is the lowest price if it is an order to buy a highest price if it is one sell at the time when the order is executed.
(ii) Limit Orders: Limit orders instruct a broker to buy or sell as a stated price 'or better'. When a buyer or seller of stock feels that he can purchase or sell a stock at a slight advantage to himself within the next two or three days, he may place a limited order to sell at a specified price. A limit order protects the customer against paying more or selling for less than intended. A limit order, therefore, specifies the maximum or minimum price the investor is willing to accept for his trade. The only risk attached to a limit order is that the investor might lose the desired purchase or sale altogether for a trifle margin. For example, if an investor instructs his broker to buy 10 shares of a company, at limit price of Rs. 20, the market price at the time of this limit order is placed at 21. The order will 'go on' the broker’s records at 20 and 'stay in' for however long the investor specifies. It cannot be executed except at 20. Indeed, it may never be executed at all. On the other hand, if he wishes to sell stock which is selling at 21 in the market and he enters a limit order of 23, he runs the risk that the stock may never go up to 23 and he may not be able to sell and on the contrary, the price may go down.

(iii) Stop Order: Another type of order that may be used to limit the amount of losses or to protect the amount of capital gains is called the 'stop order'. This order is sometimes also called the "stop loss order". Stop orders are useful to both speculators and investors. Stop orders to sell can be used to sell out holdings automatically in case a major decline in the market occurs. Stop orders to buy can be used to limit possible losses on a short position. It may also be used to buy if a market price seems to indicate a major upswing in the market. They are most frequently used as a basis for selling a stock once it's price reaches a certain point. Suppose an investor owns securities in a company X whose current market price is Rs. 44. After an analysis, he finds that the market condition is
Overview of capital market in India

uncertain and the price can move either way. To minimize the potential loss, he stops order at Rs. 42. If the market price goes down, his shares will be selling at 42. If the market price rises, he has nothing to lose. On the contrary, if the market price rises to 50, to ensure some gain on this price rise, the investor might raise the stop loss order at 48. The investor may gain if all his securities are sold at 48. Most likely, he will not be able to off-load all at the price but he will ensure that no loss arises out of this transaction. He might even be expecting some profit.

The market order, limit order and the stop order are main kinds of order. There are various other discretionary orders also in the securities market. Some examples are the Best Rate Order and Nett Rate Order. These orders are executed through various trading techniques.

3.12 Legal Control of Stock Exchanges in India

Control is an important factor for a stock exchange to thrive. The Stock Exchange in India is regulated by the Securities Contracts (Regulation) Act of February 20, 1957. The salient points of the Acts are discussed below:

(a) Recognized Stock Exchange: - Under the Act, every stock exchange must apply for recognition to the Central Government. A recognized Stock Exchange has to ensure:
   i) That it will follow the rules and bye-laws of Statute.
   ii) That it will act in accordance with the conditions laid down by the Central government failing which the Central Government may withdraw recognition.

(b) Control by Central Government: - Under the Act, the Central Government has the right to control the stock exchange in the following ways:
i) By requiring stock exchanges to furnish periodical returns about their affairs.

ii) By requiring stock exchanges to provide any explanation returns about their affairs.

iii) By requiring the submission of the annual report.

iv) By exerting its right, the Central Government may make an enquiry into the working of any recognized stock exchange.

v) The Central Government may also order suspension of business and supersede governing boards of stock exchanges if business is conducted in violation of rules.

vi) The Central Government may appoint its own nominees on any stock exchange subject to a maximum limit of three.

vii) It may also compel companies to get them listed and also to comply with listing arrangements.

(c) Regulatory Measures: - Central Government regulates the working of a stock exchange in the following manner.

i) It frames bye-laws regarding time of trade and hours of work in stock exchange.

ii) Regulation or abolition of speculative trades like options, badla and blank transfers.

iii) Maintenance of clearing houses.

iv) Frames arbitration rules to be followed during disputes.

v) Fixation of brokerage fees and license.

(d) Curbs on Speculation: - The Act has made various curbs on speculation. These are.


ii) Making option dealings before the Act void and
iii) Discouraging blank transfers.

(e) **Directorate of Stock Exchanges:**

A Directorate of Stock Exchanges was set up in 1959. It administers and implements the bye-laws contained in the Securities Regulation Act. It is both in an advisory position as well as in a position of implementing laws. It controls the activities of the stock exchange and maintains a close watch over operations and other illegal dealings. It also gives license to dealers on unrecognised stock exchanges. It maintains a liaison between the Government and the stock markets in India.

(f) **Securities Exchange Board of India:**

The Securities and Exchange Board of India (SEBI) was established by an Act of Parliament in 1992 following the dissolution of the Controller of Capital Issue (CCI), which derived and exercised its powers in terms of capital issue (Control) Act, 1947. The controller of Capital issue regulated the private sector companies in their activities relating to securities to be issued in the primary market, timing of new issues, composition of securities to be issued, interest and dividend rates to be offered on debentures and preference shares, issues relating to price of right issues and premium on securities.

The Controller of Capital Issue was considered to be an ineffective and dormant institution not responsive to changes in the stock market and issues relevant to the dynamics of developing economy. SEBI was set up to take up these new challenges through promotional but regulatory measures. SEBI was given regulatory powers over intermediaries like Underwriters, Registrars to issue, Bankers entrusted with Issue work, Share transfer agents and Debenture trustees - the objective of the Board being two-fold, protecting investors' interest and developing securities market. The board was formed with the Chairman, two members of
Overview of capital market in India

Government of India Ministry of Law and Finance, one member from the RBI and two other members. The head office of SEBI is at Mumbai.

There are five major areas which SEBI took up – i) Primary market ii) Secondary market iii) Mutual funds and iv) Foreign institutional agencies. The main objective of SEBI in the primary market was to improve the transparency and standard of disclosures in the public issues. In the secondary market SEBI was to help in the transformation process of Stock Exchanges through modernization, raising accounting standards of firms and intermediaries and professionalizing stock brokering system and having uniform by-laws for stock exchanges. Amongst the promotional steps, SEBI was to promote investors’ education and training of intermediaries in the securities market, conduct research and regulate substantial acquisition of shares and takeover of companies and thereby curb unfair and fraudulent practices relating to securities market especially relating with insider trading practices. SEBI was also to take an interest in mutual funds. All mutual funds were to be registered with SEBI and were to provide portfolio disclosure and standardization of accounting policies. SEBI would provide guidelines for valuation norms and pricing of issues. SEBI also had a role with Foreign Institutional Investors (FIIs). It was also to issue guidelines to FIIs and business could be conducted by them after registering themselves with SEBI.

The most important function of SEBI was to protect investors by acting as a regulatory mechanism enlightening and guiding them on various issues related to the securities market providing an insight to them of their rights and limitations and remedies to the situation by handling investors’ complaints relating to delay in receiving shares or refund orders and to ensure that no malpractice take place in allotment of shares.
(g) Over the Counter (OTC) Market:

As an extension to the stock market activity, an 'over the trading counter' has been formed. The primary objective of an OTC is to help small or medium companies with viable projects but high risks. The capital base of the companies which would be benefited would be between 50 lakh and 3 crore. The OTC market would be decentralized and extend their operations beyond the frontiers of the stock exchange.

3.13 Growth of Stock Exchanges

The stock exchange in Mumbai is more than 100 years old. Bombay Stock Exchange was formed in 1875, Calcutta and Madras in 1908 followed by Delhi stock exchange established in 1947. The table given below presents the organization of stock exchanges in India.
<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Name of Stock Exchange</th>
<th>Year of establishment</th>
<th>Type of Association</th>
<th>Recognition Original Date</th>
<th>Permanent Date</th>
<th>Entrance Fee/ Par value of Share</th>
<th>No. of Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.</td>
<td>Calcutta</td>
<td>1908 (incorporated in 1923)</td>
<td>Public Limited Company</td>
<td>10.10.1957</td>
<td>5 years @ 14.4.1980</td>
<td>5000</td>
<td>957</td>
</tr>
<tr>
<td>3.</td>
<td>Madras</td>
<td>1908 (recognised on 29.4.1957)</td>
<td>Public Limited Company</td>
<td>15.10.1975</td>
<td>5 years @ 15.10.1992</td>
<td>25000</td>
<td>181</td>
</tr>
<tr>
<td></td>
<td>Company</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.</td>
<td>Hyderabad</td>
<td>1943</td>
<td>Company Limited By Guarantee</td>
<td>29.9.1958</td>
<td>5 years @ 29.9.1983</td>
<td>25000</td>
<td>304</td>
</tr>
<tr>
<td>7.</td>
<td>MP (Indore)</td>
<td>1930</td>
<td>Voluntary Non profit</td>
<td>4.12.1958</td>
<td>5 years @ 24.12.1988</td>
<td>5000</td>
<td>174</td>
</tr>
<tr>
<td>8.</td>
<td>Bangalore</td>
<td>1957</td>
<td>Incorporated as a Pvt. Ltd. Co. and converted into Public Ltd. Co. on 3.4.1962</td>
<td>16.2.1963</td>
<td>5 years @ 16.2.1983</td>
<td>1000</td>
<td>256</td>
</tr>
<tr>
<td>9.</td>
<td>Cochin</td>
<td>1978</td>
<td>Public Limited Company</td>
<td>10.5.1979</td>
<td>5 years @ --</td>
<td>5000</td>
<td>435</td>
</tr>
<tr>
<td>10.</td>
<td>UP (Kanpur)</td>
<td>1982</td>
<td>Public Limited Company</td>
<td>3.6.1982</td>
<td>5 years @ --</td>
<td>101000</td>
<td>354</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>11.</td>
<td>Pune</td>
<td>1982</td>
<td>Company Limited By Guarantee</td>
<td>2.9.1982</td>
<td>5 years</td>
<td>--</td>
<td>2500</td>
</tr>
<tr>
<td>12.</td>
<td>Ludhiana</td>
<td>1983</td>
<td>Public Limited Company</td>
<td>29.4.1983</td>
<td>5 years</td>
<td>--</td>
<td>10000</td>
</tr>
<tr>
<td>13.</td>
<td>Guahati</td>
<td>1984</td>
<td>Public Limited Company</td>
<td>1.5.1984</td>
<td>5 years</td>
<td>--</td>
<td>5000</td>
</tr>
<tr>
<td>17.</td>
<td>Bhubaneshwar</td>
<td>1989</td>
<td>Company</td>
<td>5.6.1989</td>
<td>5 years</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Limited By Guarantee</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>----------------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>20.</td>
<td>Vadodara</td>
<td>1990</td>
<td>N.A.</td>
<td>5.11.1990</td>
<td>5 years</td>
<td>--</td>
<td>25000</td>
</tr>
</tbody>
</table>

@ Renewed after every 5 years till grant of permanent recognition

$ Renewed for further 5 years from 8.5.1989

* Cash deposit as security and Rs. 50000 bank guarantee of shares of the market value of Rs. 75000 of reputed listed companies

+ Membership security

N. A. Not available

Table 3.3 presents the organisation of stock exchanges in India. There are twenty two stock exchanges in the country. The organisation of stock exchanges varies. Some are public limited companies (13), while others are limited by guarantees (6), or as voluntary non profit making organisations (3). The Government of India ensures broad uniformity in structure while granting recognition. Only eight exchanges have got permanent recognition. Others have to renew it every year until permanent recognition is granted. Each member of the stock exchange has to pay an entrance fee or acquire specified number of shares. The value of shares ranges from Rs. 250 in the case of Canara (Mangalore) stock exchange to Rs. 1,01,000 in the case of U.P. (Kanpur) exchange. Security deposit to be made by members ranges from Rs. 10000 in the case of U.P. (Kanpur) exchange to Rs. 2,00,000 in the case of Bombay. The annual subscription by members varies from Rs. 1000 in the case of Canara (Mangalore) exchange to Rs. 5000 in the case of Bombay exchange. The number of members is highest at Calcutta with 957 whereas Canara exchange has the smallest, 59.

The stock exchanges are managed by a governing body which consists of a President, a Vice- President, Executive Director, elected Directors, public representatives and nominees of the Government. The governing body is responsible for policy formulation and for ensuring smooth functioning of the exchange. The executive functions are discharged by the Executive Director or Secretary.

The legislative jurisdiction over stock exchanges is vested in the Union Government by the constitution of India. The Union Government enacted the Securities Contracts (Regulation) Act in 1956 (SCR Act) for the regulation of stock exchanges and contacts in securities traded on the stock exchanges. The SCR Act and the Securities Contracts (Regulation) Rules
(1957) constitute the legal framework for the regulation of stock exchanges and the protection of interest of the investors.

For regulation and control of transactions in the exchange, each exchange has bye-laws and regulations, which are more or less uniform in all exchanges.

Under the SCR Act, an exchange is defined as any body of individuals, whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities.

The SCR Act stipulates that a stock exchange must be recognised by the Government of India. The twenty two exchanges that are operating in the country are recognised by the government. There are other statutes applicable to stock exchanges, namely the Companies Act, 1956, Income Tax Act, 1961 and Foreign Exchange Regulation Act, 1973.

Until 1988, the exchanges were more or less self regulatory with a broad overall supervision by the Ministry of Finance in the Government of India. The High Powered Committee on Stock Exchange reforms in its report in 1984 highlighted that some of the exchanges had not been discharging their self regulatory role well with the result that malpractices had crept into trading and interests of the investors were adversely affected. Consequent to the report, the Government of India issued several guidelines to stock exchanges. In 1988, the Securities and Exchange Board of India (SEBI) was constituted to ensure that stock exchanges discharge their self regulatory role well. To prevent malpractices in trading in shares and to protect the rights of investors, SEBI has assumed the monitoring function envisaged for it and requires the brokers to be registered and the stock exchanges to report on their activities.

---

Overview of capital market in India

In the past forty six years (1946-1992) the stock markets have made remarkable progress. The table given below presents the trends in number of stock exchanges, listed companies, number of stock issues of listed companies and market value of capital of listed companies.
<table>
<thead>
<tr>
<th></th>
<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 exchange</td>
<td>7</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>14</td>
<td>20</td>
<td>22</td>
<td>21</td>
<td>185</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>4344</td>
<td>6229</td>
<td>6480</td>
<td>4895</td>
<td>476</td>
</tr>
<tr>
<td>3. No. of stock issues of listed companies</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>
<td>7793</td>
<td>540</td>
</tr>
<tr>
<td>4. Capital of listed companies (Rs. Cr.)</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>
<td>189784</td>
<td>15009</td>
</tr>
<tr>
<td>5. Market value of</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>
<td>--</td>
<td>36368</td>
</tr>
<tr>
<td>capital of listed companies (Rs. Cr.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>6. Capital per listed company (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>
<td>--</td>
<td>1663</td>
</tr>
<tr>
<td>7. Market value of capital per listed company (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>
<td>--</td>
<td>4170</td>
</tr>
</tbody>
</table>

Table 3.4 given above shows that the number of stock exchanges has gone up from seven to twenty two, the number of listed companies went up from 1125 in 1946 to 6480 in 1992 (476 percent); the number of stock issues of listed companies has gone up from 1506 to 9642 (540.2 percent), capital of listed companies has increased from Rs. 270 crores to Rs. 40796 crores (15010 percent) and market value of listed capital from Rs. 971 crores to Rs. 354106 crores (36368 percent). Market capitalization of equity which rose to a spectacular high of Rs. 305987 crores or $ 95 billion placed India among the top ten stock markets in terms of price change and total return. Average capital per listed company rose from Rs. 24 lakhs to Rs. 4.23 crores and market value of capital per listed company rose from Rs. 86 lakhs to Rs. 36.73 crores.

The growth in the listed companies’ paid up capital and market value of shares is also reflected by the table given below.
Table 3.5

Market value of equity (All stock exchanges) and Gross National Product
(Rs. in Crores)

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross National Product (Current Prices)</th>
<th>Market value of listed equity</th>
<th>Col. 3 as % of Col. 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986-87</td>
<td>257250</td>
<td>22159</td>
<td>8.6</td>
</tr>
<tr>
<td>1987-88</td>
<td>291647</td>
<td>26511</td>
<td>9.0</td>
</tr>
<tr>
<td>1988-89</td>
<td>349105</td>
<td>38133</td>
<td>10.9</td>
</tr>
<tr>
<td>1989-90</td>
<td>392524</td>
<td>55409</td>
<td>14.1</td>
</tr>
<tr>
<td>1990-91</td>
<td>443552</td>
<td>82810</td>
<td>18.7</td>
</tr>
<tr>
<td>1991-92</td>
<td>609500</td>
<td>305987</td>
<td>50.2</td>
</tr>
<tr>
<td>2003-04</td>
<td>2538171</td>
<td>902831</td>
<td>35.57</td>
</tr>
<tr>
<td>2004-05</td>
<td>2877706</td>
<td>1350394</td>
<td>46.93</td>
</tr>
<tr>
<td>2005-06</td>
<td>3275670</td>
<td>1975603</td>
<td>60.31</td>
</tr>
<tr>
<td>2006-07</td>
<td>3790063</td>
<td>3522527</td>
<td>92.94</td>
</tr>
</tbody>
</table>


Table 3.5 given above reflects the rising proportion of market value of listed equity to Gross National Product from 8.6 percent in 1986-87 to 58.1 percent in 1991-92 and finally to 92.94 in the year 2006-07.

The market capitalization of India as compare to other countries can be seen from the table given below.
Table 3.6
Market capitalization in selected countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Market capitalization (US$ billion) as on 30.12.2007</th>
<th>Market capitalization as a percent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>4,459.48</td>
<td>137.3</td>
</tr>
<tr>
<td>India</td>
<td>1,638.20*</td>
<td>150.0</td>
</tr>
<tr>
<td>Japan</td>
<td>4,535.08</td>
<td>104.4</td>
</tr>
<tr>
<td>South Korea</td>
<td>1,103.34</td>
<td>116.2</td>
</tr>
<tr>
<td>United States of America</td>
<td>17,773.05</td>
<td>128.8</td>
</tr>
</tbody>
</table>

♦Market capitalization of BSE 500
Source: Derived from various country sources.

One of the important indicators to assess the size of the capital market is the ratio of market capitalization to GDP. Table 3.6 given above shows the comparative standing of India with respect to market capitalization in other selected countries. It can be seen from the table that in India as on December 30, 2007, market capitalization (BSE 500) at US$ 1,638 billion was 150 per cent of GDP, which compares well with the other emerging economies as well as select matured markets.

The activities of Bombay stock Exchange (BSE) have also increased tremendously and accounted for 70 percent of the activity of all stock exchanges in India. The table given below shows the hike in turnover and deliveries, both in terms of the number of shares and their value.
Table 3.7
Activity in Bombay Stock Exchange

<table>
<thead>
<tr>
<th>Year</th>
<th>Turnover</th>
<th>Deliveries</th>
<th>Delivery value as % of turnover</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs. Cr.</td>
<td>% change</td>
<td>No. of shares No. (000)</td>
</tr>
<tr>
<td>1986-87</td>
<td>13692</td>
<td>--</td>
<td>53022</td>
</tr>
<tr>
<td>1987-88</td>
<td>7912</td>
<td>-42.2</td>
<td>51691</td>
</tr>
<tr>
<td>1988-89</td>
<td>20562</td>
<td>160.0</td>
<td>113741</td>
</tr>
<tr>
<td>1989-90</td>
<td>29384</td>
<td>42.9</td>
<td>141407</td>
</tr>
<tr>
<td>1990-91</td>
<td>36011</td>
<td>22.5</td>
<td>193123</td>
</tr>
<tr>
<td>1991-92</td>
<td>71777</td>
<td>116.0</td>
<td>295705</td>
</tr>
<tr>
<td>% increase over 4 years</td>
<td>--</td>
<td>249.1</td>
<td>--</td>
</tr>
<tr>
<td>2007-08</td>
<td>115454</td>
<td>--</td>
<td>676.71*</td>
</tr>
</tbody>
</table>

*Figure in Crore

Table 3.7 given above reveals that the activity at BSE measured in terms of turnover has increased by 249.1 percent in the four year period (1988-89 to 1991-92) from Rs. 20562 crores in 1988-89 to Rs. 71777 crores in 1991-92. The market in the last four years 1988-89, 1989-90, 1990-91 and 1991-92 has been buoyant. The average daily turnover during 1991-92 was about Rs. 350 crores as compared to Rs. 135.42 crores in 1989-90. During the period 1988-89 to 1991-92 physical delivery of shares (in number) has gone up by 160 percent from 11.37 crore shares to 29.57 crore shares. Over a period the turnover in the year 2007-08 rose to Rs. 115454.
crores. The number of trades per day has also reached a record level of about 100000 per day which is quite high even in global terms. The trades per second position, is second only to Taipei and far ahead of the developed exchanges in Tokyo, New York and London. In emerging Market Fact Book 1993, International Finance Corporation lists India among top ten world markets.

3.14 Conclusion

Capital markets discharge the important function of transfers of savings, especially of the household sector to the companies, governments and public sector bodies. The process of industrial development requires, as one of its accompanying structural changes, the development of capital market. The capital market should be capable of meeting the requirements of credit and finance of the private entrepreneurs. The capital market should also help in sustained national industrial development.