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Chapter 2: FINANCIAL SYSTEM

02.01 Introduction to Financial System

The economic development of an economy is reflected by the progress of its various economic units, which may be broadly classified into corporate sector, government and household sector. In due course of performance of their activities, these units are placed in surplus or deficit or balanced budgetary situations. At any specific time some units may be in a surplus situation while the other units may be in a deficit situation. While government’s role is to balance the surplus and deficit situation of economic units. Financial System enables the transfer of funds from the savers (units in surplus situation) to the borrowers (units in deficit situation). It represents a channel through which savings are mobilized from the surplus economic unit and routed to the deficit economic unit. The prime function of financial system is to mobilize savings in a way to provide a potentially profitable and low–risk outlet which is known
as the savings function. Through the policy function, the government ensures a smooth flow of funds from savings into investments in order to stabilize the economy. Savings and policy function are further followed by the credit function of financial system, which ensures that these savings get transformed into necessary credit for investment and spending purposes.

Complexities may arise while performing these functions, especially when the requirements of savers and those of borrowers do not match. The main considerations of savers will be with regard to the safety of funds, returns and liquidity. On the other hand, the needs of the borrowers will be relatively diversified. Their concern will primarily relate to the term for which the funds are available and the cost of such funds. These varied requirements of the lenders and the borrowers will lead to a mismatch in periods, where lending period may differ from the period of needs of borrower. Similarly, the risk exposure and the corresponding returns may not suit the lender. Due to these factors there was a need for the development of financial system in such a way that these disparities may be coped
with. This led to the evolution of financial system thereby widening its scope of operations.

On the basis of aforesaid considerations the functional concept of financial system has been defined as under:

**Financial system** refers to “the system that allows the transfer of money between savers and borrowers”\(^1\)
02.02 Constituents of Financial System

Further it may be observed that financial system comprises of three fundamental constituents, being financial assets, financial markets and financial intermediaries respectively.

02.02.01 Financial Assets

Financial assets represent the financial obligations that arise when the borrower raises funds in the financial markets. In exchange for funds lent, supplier will have a claim on the income of borrower which may be any of the three economic units. This financial claim may be in the form of a certificate, receipt or any other legal document. Financial assets play a key role in developing the financial markets in particular and financial system in general. Financial assets include stocks, bonds, deposits, etc.
02.02.02 Financial Markets

Being entrusted with different functions having macro level implications on the nation’s economy, financial system tries to fulfill its role through the financial markets. Financial markets channelize the savings of households and other surplus budget units to those individuals and institutions that require funds. While performing this role, financial markets aid in increasing production and income of various units. The importance of these markets to the financial system may be tacit from the quantum of funds that are made available to the borrowers.

Financial markets present today have come a long way from the informal markets that existed earlier. According to the changing and increasing needs of lenders and borrowers, financial markets have also developed. These markets have witnessed remarkable changes in the nature of transactions, types of participants, magnitude of operations and various other characteristics. Depending on the differing requirements, various sub-markets have developed. The
present organized financial markets are divided into various segments as under:

- **Money Market** is a wholesale debt market for low-risk, highly liquid, short-term instruments. Funds are available in this market for periods ranging from a single day up to a year. This market is primarily dominated by government, banks and financial institutions.

- **Capital Market** is the market for securities, where companies and government can raise long-term funds. It is a market in which money is lent for long periods. Capital market includes stock market and bond market. In India trading in futures and options is also done in the stock market.

- **Forex Market** deals with multi-currency requirements which are met by the exchange of currencies. Depending on the exchange rate that is applicable, transfer of funds take place in this market. It is one of the most developed and integrated market across the globe.

- **Credit Market** is a place where banks, financial institutions (FIs) and non-banking financial companies (NBFCs) provide short, medium and long-term loans to corporates and individuals.
02.03 Growth of Financial Markets in India

The Reserve Bank of India has taken a proactive role in the development of financial markets, particularly over the past decade and a half of overall economic policy reforms. There has been a complete transformation of the money market, the government securities market, and the foreign exchange market over this period. Development of these markets has been done in a calibrated, sequenced and careful manner in step with those in other markets in the economy. The sequencing has also been informed by the need to develop market infrastructure, technology and capabilities of market participants and financial institutions in a consistent manner. In a low income economy like India, the cost of downside risk is very high, so the objective of maintaining financial stability has to be constantly kept in view as development of financial markets is in continuance.

From the point of view of the central bank, developed financial markets are critical for effective transmission of monetary policy impulses to the rest of the economy. Monetary transmission cannot take place without efficient price discovery, particularly with respect to interest rates and exchange rates. Deep and liquid financial markets contribute to efficient price discovery in various segments of the financial market. Well-integrated markets improve
efficacy of policy impulses by enabling quick transmission of changes in the central bank’s short-term policy rate to the entire spectrum of market rates, both short and long-term, in the money, the credit and the bond markets. However, various benefits emanating from the functioning of the financial markets depend critically upon the resilience of various segments of the market to withstand shocks and the strength of the risk management systems in place. In view of the critical role played by the financial markets in financing the growing needs of various sectors of the economy, it is important that financial markets are developed further and well integrated. In recognition of the critical role of the financial markets, the initiation of the structural reforms in the early 1990s in India also encompassed a process of phased and coordinated deregulation and liberalization of financial markets. Financial markets in India in the period before the early 1990s were marked by administered interest rates, quantitative ceilings, statutory pre- emptions, captive market for government securities, and excessive reliance on central bank financing, pegged exchange rate, and current and capital account restrictions. As a result of various reforms, the financial markets have transited to a regime characterized by market-determined interest and exchange rates, price-based instruments of monetary policy, current account convertibility, phased capital account liberalization and an auction-based system in the government securities market.
Excessive fluctuations and volatility in financial markets can mask the underlying value and give rise to confusing signals, thereby hindering efficient price discovery. Accordingly, policy efforts have also aimed at ensuring orderly conditions in financial markets. Furthermore, deregulation, liberalization, and globalization of financial markets pose several risks to financial stability. Financial markets are often governed by herd behavior and contagion and excessive competition among financial institutions can also lead to a race to the bottom. The East Asian crisis of the 1990s suggested that global financial markets can exacerbate domestic vulnerabilities. Notwithstanding the conventional wisdom that financial markets punish deviations from prudent policies, financial markets, at times, seem to tolerate imprudent behavior for a remarkable stretch of time, while reacting pre-maturely at other times (Lipschitz, 2007). In recognition of these possible destabilizing factors, while liberalizing domestic financial markets in India, appropriate prudential safeguards have also been put in place. Enhancing efficiency, while at the same time avoiding instability in the system, has been the challenge for the regulators in India (Reddy, 2004). This approach to development and regulation of financial markets has imparted resilience to the financial markets.
From the point of view of the economy as a whole, while developing financial markets it is essential to keep in view how such development helps overall growth and development. The price discovery of interest rates and exchange rates, and the integration of such prices across various constituents of financial market help in the efficient allocation of resources in the real sectors of the economy. Financial intermediaries like banks also gain from better determination of interest rates in financial markets so that they can price their own products better. Moreover, their own risk management can also improve through the availability of different varieties of financial instruments. The access of real sector entities to finance is also assisted by the appropriate development of the financial market and the availability of transparent information on benchmark interest rates and prevailing exchange rates. The approach of the RBI in the development of financial markets has been guided by these considerations, while also keeping in view the availability of appropriate skills and capacities for participation in financial markets both among financial market participants and real sector entities and individuals. The RBI's approach has therefore been one of consistent development of markets while exercising caution in favor of maintaining financial stability in the system.
**02.04 Functions of Capital Market**

An efficient capital market is characterized to perform various functions, which are summarized as follows:

- Mobilizing long-term savings to finance long-term investments.
- Providing risk-capital in the form of equity or quasi-equity to entrepreneurs.
- Encouraging broader ownership of productive assets.
- Providing liquidity with a mechanism enabling an investor to sell financial assets.
- Reducing the cost of transactions and information.
- Improving the efficiency of capital allocation through a competitive pricing mechanism.
- Disseminating information efficiently for enabling participants to develop an informed opinion about investment, disinvestment, reinvestment, or holding a particular financial asset.
- Enabling quick valuation of financial instruments - both equity and debt.
Providing insurance against market risk or price risk through derivative trading and default risk through investment protection fund.

Enabling ample participation by enhancing the width of market.

Encouraging participation through networking institutions and associating individuals.

Providing operational efficiency through:

- Simplified transaction procedures;
- Reducing settlement timings;
- Reducing transaction costs;

Developing integration amongst:

- Real and financial sectors;
- Equity and debt instruments;
- Long–term and short–term funds;
- Long–term and short–term interest costs;
- Private and Public sectors;
- Domestic and external funds.
• Directing the flow of funds into efficient channels through investment, disinvestment and reinvestment.
The capital market is a place where the suppliers and users of capital meet to share one another’s views, and where a balance is sought to be achieved among diverse market participants. The securities decouple individual acts of saving and investment over time, space and entities and thus allow savings to occur without concomitant investment. Moreover, yield-bearing securities makes present consumption more expensive relative to future consumption, inducing people to save. The composition of savings changes with less of it being held in the form of idle money or unproductive assets, primarily because more divisible and liquid assets are available.

The capital market acts as a brake on channeling savings to low-yielding enterprise and impels enterprises to focus on performance. It continuously monitors performance through movements of share prices in the market and the threats of takeover. This improves efficiency of resource utilization and thereby significantly increases returns on investment. As a result, savers and investors are not constrained by their individual abilities, but facilitated by the economy’s capability to invest and save, which inevitably enhances savings and investment in the economy. Thus, the capital market converts a given stock of investible resources into a larger flow of goods and services and augments economic growth.
In fact, the literature is full of theoretical and empirical studies that have established causal robust (statistically significant) two-way relation between the developments in the securities market and economic growth.

The Indian capital markets dates back to the 18th century when the securities of the East India Company were traded in Mumbai and Kolkata. However, the orderly growth of the capital market began with the setting up of The Stock Exchange, Bombay in July 1875 and Ahmedabad Stock Exchange in 1894. Eventually, 22 other Exchanges in various cities sprang up.

Given the significance of capital market and the need for the economy to grow at the projected over 8 percent per annum, the managers of the Indian economy have been assiduously promoting the capital market as an engine of growth to provide an alternative yet efficient means of resource mobilization and allocation. Further, the global financial environment is undergoing unremitting transformation. Geographical boundaries have disappeared. The days of insulated and isolated financial markets are history. The success of any capital market largely depends on its ability to align itself with the global order.

To realize national aspirations and keep pace with the changing times, the capital markets in India have gone through
various stages of liberalization, bringing about fundamental and structural changes in the market design and operation, resulting in broader investment choices, drastic reduction in transaction costs, and efficiency, transparency and safety as also increased integration with the global markets. The opening up of the economy for investment and trade, the dismantling of administered interest and exchange rates regimes and setting up of sound regulatory institutions have enabled this.

**Primary Market**

The primary market, which at one time was flooded with a number of issues floated by dubious promoters, depriving gullible investors of their life-time savings has since been transformed. The changes in this area have been epoch-making and include detailing of complete profile of promoters, comprehensive disclosures, the existence of tangible assets and a track record of profit as also reporting end uses of funds to the Company Board as a part of corporate governance, etc. Sometime back when the story of Google’s IPO was being flaunted around the world in various sections of media as one of the greatest innovations of recent times in raising risk capital, the Financial Times, London, carried the following observation:
“The World’s Biggest Democracy can show Google how to conduct an online IPO.

…in India you cannot apply on the web but investors can access one of the world’s largest financial networks with 7000 terminals scattered around 350 cities. And every step of the book building process is public. The Indian system is a refreshing example of a transparent IPO market but it is also a rare one, especially in the insider-friendly Asian markets.”

All the IPOs since the reforms started have been a success and barring a few exceptions are trading at a premium over the issue price. The regulatory framework has been modified to provide options to Indian firms for raising resources either domestically, or globally, or through both. This helps in price discovery and reducing the cost of funds. A number of Indian firms have raised money through American Depository Receipts (ADR), Global Depository Receipts (GDR) and External Commercial Borrowings (ECB). Two way fungibility has been permitted to enhance liquidity. During 2005-06, a sum of Rs. 273 billion, as against Rs. 232.71 billion in 2003-04, and the amount raised was next only Hong Kong and way ahead of Japan, Korea & Singapore through primary market. In fact, the corporate sector and governments (Centre and States) together raised a total of Rs. 3.75 trillion from the securities market during 2005.
Secondary Market

If a Rip Van Winkle woke up from a prolonged deep slumber of a couple of years, he would be amazed to see the quality of the secondary market of India. The deafening noise of an out-cry trading system has been replaced with a silence of a summer through the Electronic Consolidated Anonymous Limit Order Book, with price time priority matching being accessed through more than 10,000 terminals spread in over 400 cities and towns across the Indian sub-continent, something perhaps without a parallel in the world. The cost of transacting is the lowest, as compared to the most developed markets.

The Indian Settlement system conforms to the CPSS-IOSCO (Committee on Payment and Settlement-International Organization of Securities Commissions) principles and G30 committee (January 2003, under the chairmanship of Sir Andrew Large) recommendations, which even the most developed markets of the world have been proposing to implement by end of 2006. The institution of central counter party (CCP), which provides full notation and guarantees settlement, has eliminated counter party risk entirely. Over 99 percent of the dematerialization of market capitalization and Straight-Through Processing (STP), mandatory for all institutional trades, have enabled Indian settlement system to function seamlessly, notwithstanding the size and spread.
On a T+2 cycles, all scrips are electronically cleared fully through a central counter party (CCP) on a rolling settlement. The CCP of the exchanges, which operates a tight risk management system and maintains short (T+2) and consistent settlement cycle, is now financially potent to meet the obligations for 4-5 consecutive settlements even if all the trading members default in their obligations. The dynamic risk management system comprises capital adequacy norms, trading and exposure limits, index-based market-wide circuit breakers, margin (mark to market) requirements. The encashability of the underlying of the margins, comprising cash, bank guarantees and securities is evaluated periodically. The real time monitoring of broker positions and margins and automatic disablement of terminals with Value-added Risk (VaR) margining, built on much higher sigma deviation than the best of the markets in the world, has reduced the operational risk to the lowest ebb. In an unfortunate very sharp (over 25 percent in two days) fall of the market in May 2004 the strength of the risk management of the system got tested to the hilt. There was not a single broker failure or default and on the third day (after the two consecutive days of fall) the market functioned as if nothing unusual had happened. Even the CCP was not required to fund any broker- dealer’s obligations.

The three- legged corporate compliance stool- disclosure, accounting standards and board room practices - has lifted India to
the global pedestal in corporate governance. In a study titled “What works in Securities Laws? ” Professors Rafael La Porta, Florencio Lopez - de- Silanes and Andrei Shleifer have commented:

“India scores 100% as far as disclosure standards are concerned”.³

The Indian accounting standards are aligned with international accounting standards and are ‘principle based’. One of the most sophisticated Pension Fund Managers, CalPERS gave a score of 3 (maximum that could be awarded) via permissible equity market analysis while voting for India as an investment destination. CLSA-CG Watch, in its September 2004 report, says: “In terms of consolidation, segmental reporting, deferred tax accounting and related party transactions, the gap between Indian and US GAAP is minimal.”

On corporate governance it might be worthwhile to recall what the Economic Intelligence Unit 2003 study said:

The Asian Experience incorporates - “Top of the Country class, as might be expected is Singapore followed by Hong Kong and somewhat surprisingly, India where overall disclosure standards have improved dramatically, accounting differences between local and US standards have been minimized and the number of
companies with a majority of independent directors has risen significantly.”

CLSA Emerging Markets Study on Corporate Governance gives India a score of 6.2, which is next only to 7.5 for Singapore and 6.7 for Hong Kong. None of the Indian companies listed on the NYSE or NASDAQ to the public knowledge has sought the benefit of transition time for the implementation of SOX requirements. What could possibly be more comforting is the CLSA – Emerging Market Study comment: “The Securities and Exchange Board of India (SEBI) continues to raise the bar for good corporate governance.” It is not very appropriate to compare the Indian securities market with those of Singapore and Hong Kong. Singapore and Hong Kong are city states and have much smaller spectrum to watch: listed companies, broker-dealers, investors and even number of transactions.

The Indian securities market is next only to US market in terms of size. Even though by all criteria of economic research, the size of market is determined by the market capitalization and trades in dollar terms, in actual operations, the market participants and the regulators have to grapple with the number of listed securities, market participants and the volume of transactions and that is where India stands out. The NSE is third largest exchange in the world next only to NYSE, NASDAQ, by the number of transactions, followed
by the BSE, the fifth largest in the world. India has the largest
electronic order book; NYSE and NASDAQ books are quote-driven.
In the matter of single stock futures, India leads the world, followed
by EURONEXT which is just about half of its size. Even in Index-
futures, NSE volumes are next only to the Chicago Mercantile
Exchange and Eurex. No other market in the world, including that of
Japan, compares with the volume of transactions of Indian markets.
The ratio of the $((\text{Turnover}/ \text{Market capitalization}) \times 100)$ was 101%
and compares very well with Japan & Taiwan were ratio is 137.20%
and 147.30% respectively. The impact cost went below down to
0.08% in 2005-06 reflecting substantial improvement in liquidity.
The focus of development and the quality of regulation have not just
centered on primary and secondary markets, they have also been
directed at quality of intermediation and enforcement.

The Mutual Fund industry of India which has gone through a
host of reforms via the regulatory interventions today has some
outstanding features like benchmarking Mutual Fund schemes,
valuation norms, uniform cut-off time, comprehensive risk
management etc. An independent study organized by the Asian
Development Bank – Cadgon report testifies to this.

The investors and issuers can take comfort and undertake
transactions with confidence if the intermediaries as well as their
employees
(i.) follow a code of conduct and deal with probity and 
(ii.) are capable of providing professional services. All the 
intermediaries in the securities market are now registered and 
regulated by SEBI.

A code of conduct has been prescribed for each intermediary 
as well as for their employees, in addition to applicability of fit and 
proper person regulatory standards. Further, capital adequacy and 
other norms have been specified and a system of monitoring and 
inspecting their operations has been instituted to enforce 
compliance. Disciplinary action is taken against them for violating 
any ground rules. All the intermediaries in the market are mandated 
to have a compliance officer, who reports directly and 
independently to SEBI non-compliance observed by him.

The Economic Survey 2003-04 by the Government of India 
had stated the following: “The securities markets have made 
enormous progress in recent years. India’s equity market is now 
being increasingly recognized as a success story on the world 
scale.”

These reforms have boosted the confidence of investors 
(domestic and international) in Indian securities market. There are 
four parameters to ascertain the level of investor confidence: – (a) 
investments by FIIs, (b) growth of mutual funds industry, (c)
subscriptions to the IPOs and (d) the increase in the number of accounts with the depositories. Let me quote the last financial year (2005-06) figures. The mutual funds mobilized net resources of about Rs. 520 Billion, equivalent to about one fourth of incremental bank deposits. Mutual funds’ assets increased from Rs. 1.1 Billion at the end of March 2003 to Rs.300 Billion at the end of August 2006. Indian companies raised about Rs. 38 Billion through euro issues. The year gone by witnessed a net FII (portfolio moneys) inflow of US $ 14 billion.

The benchmark indices, namely the SENSEX and S&P CNX NIFTY, generated astounding returns of 83 per cent and 81per cent respectively, during 2002-03 and 2003-04. The market capitalization grew from Rs. 7 trillion at the end of March 2003 to Rs. 14 trillion at the end of March 2004 to Rs 28 trillion as on June 2006, indicating that the equity market is bigger than the banking system. The primary issues in the last year added at least Rs. 2 trillion market capitalizations. The trading in cash segment of exchanges increased from Rs. 9,32,062 crore in 2002-03 to Rs. 23,85,632 crore in 2005-06. The trading in derivatives increased from Rs. 4, 42,332 crore to Rs. 48, 40,362 crore during the same period. The turnover in government securities increased from Rs. 1,941,621 crore to Rs. 2,639,897 crore. The number of demat accounts with the Depository Participants (DPs) has increased
considerably during the last three years from 3.5 million to 8.5 million & is increasing at the rate of over 100,000 per month.

The efficacy of the market where entry and exit are possible at will and the liquidity has spread from being skewed to just about 100 to more than 500 securities, is a matter of substantial comfort. Over 2,500 securities (equity) are traded for more than 100 days in a year. The overseas investors are no more glued to researches and assessments on index stocks and have been observing keenly and investing in the mid-cap segment. The changes in the market have been really fast-paced and it has been possible with the cooperation of all the market participants, other regulators and the Government of India.

Regulatory Efficacy in Indian Capital Market

The capital markets in India were underdeveloped, opaque, dominated by a handful of players, and concentrated in a few cities. Manipulation and unfair practices were perceived to be widespread and rampant, prompting an overseas researcher to describe it as a “snake pit”. The transformation of the Indian securities markets was initiated with the establishment of the Securities and Exchange Board of India (SEBI) in 1989, initially as an informal body and in 1992 as a statutory autonomous regulatory body with the twin
objectives of protecting the interests of the investors and developing and regulating the securities markets over a period of time. SEBI has been empowered to investigate, examine, visit company premises, summon records and persons and enquire and impose penalties commensurate with misconduct. The first and foremost challenge for the fledgling regulator was to create a regulatory and supervisory framework for the market, a job that proved formidable, because vested interests resisted every new step.

However, with the designing and notification of 32 regulations/guidelines (amended many times over), during a decade and half of its existence, the apparatus steadily evolved and has come to grips with the situation. SEBI has instituted a consultative process of framing regulations. All reports, concept papers and policy proposals are posted on SEBI web site www.sebi.gov.in for comments from market participants and the public. The comments are compiled and considered before finalizing regulations. Even the draft regulations are put on the website before notification for legal experts to comment whether the law framed is in consonance with the spirit of initiatives. This has a profound impact not only in terms of receiving valuable input and building public opinion before framing regulations / guidelines but also in improving the quality, acceptability and implementibility. SEBI has formed a number of committees comprising of eminent experts and market practitioners
to support it in the design of reforms for different aspects of the markets. The regulator posts all its orders, including those delivered on appeals against its orders, on its website. On request, it provides informal guidance on payments of nominal fees and issues no action letter so that the participants can seek clarity on any aspect and adopt appropriate business strategy in consonance with the applicable regulations. SEBI has put time lines for performance of its various functions like registration and renewal on the website. These measures work as a self-disciplining mechanism within SEBI and also provide full transparency to its functioning.
02.06 Organisation, Management and Membership of Stock Exchanges

In India the organizational forms of various recognized stock exchanges along with their respective management and membership are exhibited in table 02.01 as follows:

**TABLE No. 02.01**

**Classification of Stock Exchanges**

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Type</th>
<th>Organisation/Management/Membership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bombay, Ahmedabad, Patna, Indore</td>
<td>Regional</td>
<td>Voluntary non-profit making association</td>
</tr>
<tr>
<td>Kolkata, Delhi, Bangalore, Cochin, Kanpur, Guwahati, Ludhiana, Bangalore, Chennai</td>
<td>Regional</td>
<td>Public Limited Company</td>
</tr>
<tr>
<td>Hyderabad, Pune, Rajkot, Magadh</td>
<td>Regional</td>
<td>Company Limited by Guarantee</td>
</tr>
<tr>
<td>The National Stock Exchange</td>
<td>National</td>
<td>A tax-paying company incorporated under the Companies Act and promoted by leading financial institutions and banks</td>
</tr>
<tr>
<td>The Over the Counter Exchange of India</td>
<td>National</td>
<td>A company under Section 25 of the Companies Act, 1956.</td>
</tr>
</tbody>
</table>

Source: SEBI website, 2008.
On the basis of above classification of stock exchanges in Table No.02.01 the observations are as follows:

The above mentioned regional stock exchanges of Bombay, Ahmedabad, Patna, Indore, Kolkata, Delhi, Bangalore, Cochin, Kanpur, Guwahati, Ludhiana, Chennai, Hyderabad, Pune, Rajkot, Magadh are managed by a governing body consisting of elected and nominated members. The trading members who provide broking services, own, control and manage the exchanges. The governing body is vested with wide ranging powers to elect office bearers, set up committees, admit and expel members, manage properties and finances of the exchange, resolve disputes, and conduct day-to-day affairs of the exchange.

The OTCEI and NSE are demutualised exchanges wherein the ownership and management of the exchange are separated from the right to trade on exchange.

Brokers are members of the stock exchange. They enter trade either on their own account or on behalf of their clients. They are given a certificate of registration by SEBI and they have to comply
with the prescribed code of conduct. Over a period of time many of the stock brokers with proprietary and partnership firms have converted themselves into corporate entities. Both the OTCEI and NSE have laid down strict standards for the admission of members, which relate to capital adequacy, track record, education, experience, and so on to ensure quality broking services.

Brokers are important intermediaries in the stock markets as they bring buyers and sellers together and aid in price discovery. There are three classes of brokers viz. proprietary, partnership and corporate. In the old exchanges most of the brokers are proprietary in nature, whereas in new exchanges they are corporate members. Several structural changes have taken place in the Indian broking industry over the past few years. Consolidation and reconstructuring have assumed considerable importance in this segment. As on 31st March, 2009 there were 9729 registered brokers with SEBI. The CSE has highest number of brokers followed by NSE, the OTCEI and the BSE.

Consolidation is dynamic phenomenon being experienced by the Indian broking industry as small brokerages are paving way for big broking entities which have cornered a big chunk of the broking business.
The wave of economic reforms initiated by the government has influenced the functioning and governance of the capital market. The Indian capital market is also undergoing structural transformation since liberalisation. The chief aim of the reforms exercise is to improve market efficiency, make stock market transactions more transparent, curb unfair trade practices and to bring our financial markets up to international standards. Further, the consistent reforms in Indian capital market, especially in the secondary market resulting in modern technology and online trading have revolutionized the stock exchanges. The number of listed companies increased from 5,968 in March 1990 to about 10,000 by 1999 and market capitalization has grown almost 11 times during the same period. The debt market, however, is almost non-existent in India even though there has been a large volume of Government bonds trading. Banks and financial institutions have been holding a substantial part of these bonds as a statutory liquidity requirement. A primary auction market for Government securities has been created and a primary dealer system was introduced in 1995. Currently, there are 31 mutual funds, out of which 21 are in the private sector. Mutual funds were opened to the private sector in 1992. Earlier, in 1987, banks were allowed to enter this business, breaking the monopoly of the Unit Trust of India (UTI), which maintains a dominant position. Recognizing the importance of increasing investor protection, several measures
were enacted to improve the fairness of the capital market. There have been significant reforms in the regulation of the securities market since 1992 in conjunction with overall economic and financial reforms. In 1992, the SEBI Act was enacted giving SEBI statutory powers as an apex regulator. And a series of reforms were introduced to improve investor protection, automation of stock trading, integration of national markets and efficiency of market operations. SEBI in 1993 initiated a significant move which involved the shift of all exchanges to screen-based trading being motivated primarily by the need for greater transparency. The first exchange to be based on an open electronic limit order book was the National Stock Exchange (NSE), which started trading debt instruments in June 1994 and equity in November 1994. In March 1995, Bombay Stock Exchange (BSE) shifted from open outcry to a limit order book market.
List of References:


