An Overview of the Securities Market in India

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Introduction

Efficient transfer of resources from those with idle resources to others who have a pressing need for them is achieved through securities markets. Stated formally, securities markets provide channels for allocation of savings to investments and thereby decouple these two activities. As a result, the savers and investors are not constrained by their individual abilities, but by the economy's abilities to invest and save respectively, which inevitably enhances savings and investment in the economy.

Market Segments

The securities market has two interdependent and inseparable segments, the new issues (primary market) and the stock (secondary) market. The primary market provides the channel for sale of new securities while the secondary market deals in securities previously issued. The price signals, which subsume all information about the issuer and his business including associated risk, generated in the secondary market, help the primary market in allocation of funds. The issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment and/or to discharge some obligation. They do so either through public issues or private placement. It is a public issue if any body and everybody can subscribe for the securities. If the issue is made to select people, it is called private placement. In terms of the Companies Act, 1956, an issue becomes public if it results in allotment to more than 50 persons. There are two major types of issuers of securities – the corporate issue mainly debentures and shares and the governments (central / state governments and municipal authorities) issue dated securities, treasury bills and bonds.

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risk and return. They also sell securities for cash to meet their liquidity needs. The secondary market has further two components, namely the over-the-counter (OTC) market and the exchange-traded market. OTC is different from the market place provided by the Over The Counter Exchange of India Limited. OTC markets are essentially informal markets where trades are negotiated. Most of the trades in government securities are in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not provide facility for spot trades in a strict sense. Closest to spot market is the cash market in exchanges where settlement takes place after some time. Trades taking place over a trading cycle (a day under rolling settlement or five days under account period settlement) are settled together after a certain time. All the 23 stock exchanges in the country provide facilities for trading of corporate securities. 414 most active securities are traded under rolling settlement, while the balance is traded under account period settlement. Trades executed on NSE only are cleared and settled by a clearing corporation which provides novation and settlement guarantee. Over 99% of the trades settled by delivery are settled in demat form. Two exchanges, namely NSE and BSE also provide a formal trading platform for trading of government securities.

A variant of secondary market is the forward market, where securities are traded for future delivery and payment. Pure forward is out side the formal market. The versions of forward in formal market are futures and options, called derivatives. In futures market, standardised securities are traded for future settlement. These futures can be on a basket of securities like an index or an individual security. In case of options, securities are traded for conditional future delivery and payment. There are two types of options – a put/call

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option permits the owner to sell/buy a security to/from the writer of option at a predetermined price. These options can also be on individual stocks or basket of stocks like index. Two exchanges, namely NSE and BSE provide trading of derivatives (index futures/options and stock options).

Products and Participants

Savings are linked to investments through a range of financial products called "securities". The Securities Contracts (Regulation) Act, 1956 defines "securities" to include shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of like nature in or of any incorporated company or body corporate, government securities, derivatives of securities, units of collective investment scheme, interest and rights in securities, or any other instruments so declared by the central government. There are a set of economic units who demand securities in lieu of funds and others who supply securities for funds. These demand for and supply of securities and funds determine, under competitive market conditions in goods and securities market, the prices of securities.

It is not that the users and suppliers of funds meet each other and exchange funds for securities. The amount of funds supplied by the supplier may not be the amount needed by the user. Similarly, the risk, liquidity and maturity characteristics of the securities issued by the issuer may not match preference of the supplier. In such cases, they incur substantial search costs to find each other. Search costs are minimised by the intermediaries who match the preferences and bring the suppliers and users of funds together. The intermediaries may act as agents to match the needs of users and suppliers of funds for a commission, help suppliers and users in creation and sale of securities for a fee or buy the securities issued by users and in turn, sell their own securities to suppliers to book profit. It is, thus, a misnomer that securities market disintermediates by establishing a direct relationship between the suppliers and the users of funds. The market does not work in a vacuum; it requires services of a large variety of intermediaries. The disintermediation in the securities market is in fact an intermediation with a difference; it is a risk-less intermediation, where the ultimate risks are borne by the savers and not the intermediaries. A large variety and number of intermediaries provide intermediation services in the Indian securities market as may be seen from Table 1.

Table 1: Market Participants in Securities Market

Particulars	Number as on March 31, 2001
Securities Appellate Tribunal	1
Regulators	4
Depositories	2
Stock Exchanges	23
Listed Securities	9,922
Brokers	9,782
Sub-brokers	9,957
Portfolio Managers	40
Custodians	14
Share Transfer Agents	186
Primary Dealers	15
Merchant Bankers	233
Bankers to an Issue	69
Debenture Trustees	37
Underwriters	56
Venture Capital Funds	35
Mutual Funds	39
Collective Investment Schemes	4
Investors (Estimated)	20 million

The securities market, thus, has essentially three categories of participants, namely the issuers of securities, investors in securities and the intermediaries and two categories of products, namely the services of the intermediaries and the securities. The issuers and investors are the consumers of services rendered by the intermediaries while the investors are consumers of securities issued by issuers. Those who receive funds in exchange for securities and those who receive securities in exchange for funds often need the reassurance that it is safe to do so. This reassurance is provided by the law and by custom, often enforced by the regulator. The regulator develops fair market practices and regulates the conduct of issuers of securities and the intermediaries so as to protect the interests of suppliers of funds. The regulator ensures a high standard of service from intermediaries and supply of quality securities and non-manipulated demand for them in the market.

A Profile

The past decade in many ways has been remarkable for securities market in India. It has grown exponentially as measured in terms of amount raised from the market, number of stock exchanges and other intermediaries, the number of listed stocks, market capitalisation, trading volumes and turnover on stock exchanges, and investor population. Along with this growth, the profiles of the investors, issuers and intermediaries have changed significantly. The market has witnessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant improvements in efficiency, transparency and safety.

Dependence on Securities Market

The securities market in India is now a far more important source of finance for corporate and governments (Tables 2 and 3). The corporate sector is increasingly depending on external sources for meeting its funding requirements. There is a growing preference for direct financing (equity and debt) to indirect financing (bank loan) within the external sources. External sources accounted for 65-77% of funds raised during 1990s. The share of capital market based instruments in total resources raised externally increased to 53.4% in 1993-94, but declined thereafter to 31.8% by 1999-00. Along with increase in fiscal deficits of the governments, the dependence on market borrowings to finance fiscal deficits has increased over the years. During the year 1990-91, the state governments and the central government financed nearly 14% and 18% respectively of their fiscal deficit by market borrowing. In percentage terms, dependence of the state governments on market borrowing did not increase much during the decade 1991-2001. In case of central government, it increased to 70% by 2000-01.

Table 2: Dependence on Securities Market

(In per cent)

Share of Securities Market in	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
External Finance of Corporates	15.5	19.2	33.4	53.4	45.3	21.3	20.4	28.8	22.6	31.8	—
Fiscal Deficit of Central Government	17.9	20.7	9.2	48.0	35.2	54.9	30.0	36.5	60.9	67.1	68.6
Fiscal Deficit of State Governments	13.6	17.5	16.8	17.6	14.7	18.7	17.5	16.5	14.1	13.9	13.3
Financial Savings of Households	14.4	22.9	17.2	14.0	12.1	7.8	6.9	4.5	4.1	9.5	—

Source: CMIE & RBI.

Table 3: Resource Mobilisation from the Primary Market

(Rs. crore)

Issues	1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01
Corporate Securities	**14,219**	**16,366**	**23,537**	**44,498**	**48,084**	**36,689**	**37,147**	**42,125**	**60,192**	**72,450**	**78,119**
Domestic Issues	14,219	16,366	23,286	37,044	41,974	36,193	33,872	37,738	59,044	68,963	73,922
Non-Govt. Public Companies	4,312	6,193	19,803	19,330	26,417	16,075	10,410	3,138	5,013	5,153	4,949
PSU Bonds	5,663	5,710	1,062	5,586	3,070	2,292	3,394	2,982	-	-	-
Govt. Companies	-	-	430	819	888	1,000	650	43	-	-	-
Banks & FIs	-	-	356	3,843	425	3,465	4,352	1,476	4,352	2,551	1,472
Private Placement	4,244	4,463	1,635	7,466	11,174	13,361	15,066	30,099	49,679	61,259	67,500
Euro Issues	-	-	702	7,898	6,743	1,297	5,594	4,009	1,148	3,487	4,197
Government Securities	**11,558**	**12,284**	**17,690**	**54,533**	**43,231**	**46,783**	**42,688**	**67,386**	**106,067**	**113,336**	**126,833**
Central Government	8,989	8,919	13,885	50,388	38,108	40,509	36,152	59,637	93,953	99,630	115,183
State Governments	2,569	3,364	3,805	4,145	5,123	6,274	6,536	7,749	12,114	13,706	11,650
Total	**25,777**	**28,650**	**41,227**	**99,031**	**91,315**	**83,472**	**79,835**	**109,511**	**166,259**	**185,786**	**204,952**

Source: RBI

Household sector accounted for 88% of gross domestic savings during 1999-2000; 53% of their savings were in financial assets. They invested 37% of financial savings in deposits, 35% in insurance/provident funds, 11% on small savings, and 7.5% in securities, including government securities and units of mutual funds during 1999-2000. Thus the fixed income bearing instruments are the most preferred assets of the household sector. In contrast, the share of financial savings of the household sector in securities (shares, debentures, bonds and units of UTI and other mutual funds and government securities) is estimated to have gone down from 22.9% in 1991-92 to 4.1% in 1997-98, which increased to 7.5% in 1999-2000. Though there was a major shift in the saving pattern of the household sector from physical assets to financial assets and within financial assets, from bank deposits to securities, the trend got reversed in the recent past due to high real interest rates, prolonged subdued conditions in the secondary market, lack of confidence by the issuers in the success of issue process as well as of investors in the credibility of the issuers and the systems and poor performance of mutual funds. The portfolio of household sector remains heavily weighted in favour of physical assets and fixed income bearing instruments.

Investor Population

The Society for Capital Market Research and Development carries out periodical surveys of household investors to estimate the number of investors. Their first survey carried out in 1990 placed the total number of share owners at 90-100 lakh. Their second survey estimated the number of share owners at around 140-150 lakh as of mid-1993. Their latest survey estimates the number of shareowners at around 2 crore at 1997 end, after which it remained stagnant upto the end of 1990s. The bulk of increase in number of investors took place during 1991-94 and tapered off thereafter. 49% of the share owners at the end of 2000 had entered the market for the first time before the end of 1990, 44% entered during 1991-94, 6.3% during 1995-96 and 0.8% since 1997. The survey attributes such tapering off to persistent depression in the share market and investors' bad experience with many unscrupulous company promoters and managements.

According to the SEBI-NCAER survey, an estimated 12.8 million, or 7.6%, of all Indian households representing 19 million individuals had directly invested in equity shares and or debentures at the end of financial year 1998-99. The investor households increased at a compound growth rate of 22% between 1985-86 and 1998-99. About 35% of investor households became investors in equity shares prior to 1991, while 47% of the investors entered the market during 1991-95 and 17% after 1995. More than 156 million, or 92%, of all Indian households were non-investor households who did not have any investments in equity/debentures. Low per capita income, apprehension of loss of capital, and economic insecurity, which are all inter-related factors, significantly influenced the investment attitude of the households. The lack of awareness about securities market and absence of a dependable infrastructure and distribution network coupled with aversion to risk inhibited non-investor households from investing in the securities market.

An estimated 15 million, or nearly 9%, of all households representing at least 23 million unit holders had invested in units of mutual funds. Total investible resources of mutual funds account for about 23% of market capitalisation compared to more than 50% in developed countries. The mutual funds have not yet become an attractive investment avenue for the low and middle-income groups.

Primary Market

The resources raised by non-government public companies rose sharply to Rs. 26,417 crore in 1994-95. The market, however, appears to have dried up since 1995-96. In real terms, the amount raised by non-government public companies during 2000-01 is about 53% of that raised a decade back in 1990-91. Many investors who were lured into the market during 1992-94 seem to be adopting a very cautious approach because of their frustration with some of the issuers and intermediaries associated with the securities market. The number of quality issues has declined due to stricter eligibility criteria for public issues imposed by SEBI and the general slowdown in the economic activity.

Simultaneously, issuers have shifted focus to other avenues for raising resources like private placement where compliance is much less. Available data, although scanty, indicate that private placement has become a preferred means of raising resources by the corporate sector. It accounted for about 91% of total resources mobilised through domestic issues by the corporate sector during 2000-01. It is believed in some circles that private placement has crowded out public issues. Rapid dismantling of shackles on institutional investments and deregulation of the economy are driving growth of this segment. There are several inherent advantages of relying on private placement route for raising resources. While it is cost and time effective method of raising funds and can be structured to meet the needs of the entrepreneurs, it does not require detailed compliance with formalities as required in public or rights issues.

Indian market is getting integrated with the global market though in a limited way through euro issues. Since 1992, when they were permitted access, Indian companies have raised about Rs. 31,000 crore through ADRs/GDRs.

The market is getting institutionalised as people prefer mutual funds as their investment vehicle, thanks to evolution of a regulatory framework for mutual funds, tax concessions offered by government and preference of investors for passive investing. The net collections by mutual funds picked up during the 1990s and increased to Rs. 19,953 crore in 1999-2000. This, however, declined to Rs. 13,339 crore in 2000-2001. Starting with an asset base of Rs. 25 crore in 1964, the industry has grown exponentially to nearly Rs. 1,00,000 crore at the end of June 2001. The number of households owning units of MFs exceeds the number of households owning equity and debentures.

The primary issues of the Central Government have increased thirteen-fold during the decade of 1990's from Rs. 8,989 crore in 1990-91 to Rs. 1,15,183 crore in 2000-01. The issues by state governments increased by about five times from Rs. 2,569 crore to Rs. 11,650 crore during the same period.

Secondary Market

Selected indicators in the secondary market are presented in Table 4. The number of stock exchanges increased from 11 in 1990 to 23 now. All the exchanges are fully computerised and offer 100% on-line trading. 9,922 companies were available for trading on stock exchanges at the end of March 2001. The trading platform of the stock exchanges was accessible to 9,792 members from over 400 cities on the same date.

The market capitalisation grew ten fold between 1990-91 and 1999-2000. All India market capitalisation is estimated at Rs.7,68,863 crore at the end of March 2001. The market capitalisation ratio, which indicates the size of the market, increased sharply to 57.4% by March 1992 and to 85% by March 2000. It, however, declined to 55% at the end of March 2001. Traditionally, manufacturing companies and financial services sector accounted for a major share in market capitalisation. The importance of these traditional sectors has declined in the recent past and new sectors like information technology, pharmaceuticals and fast moving consumer goods have picked up.

The trading volumes on exchanges have been witnessing phenomenal growth during the 1990s. The average daily turnover grew from about Rs.150 crore in 1990 to Rs. 12,000 crore in 2000, peaking at over Rs. 20, 000 crore. One-sided turnover on all stock exchanges exceeded Rs. 10,00,000 crore during 1998-99, Rs. 20,00,000 crore during 1999-2000 and approached Rs. 30,00,000 crore during 2000-01. The turnover ratio, which reflects the volume of trading in relation to the size of the market, has been increasing by leaps and bounds after the advent of screen based trading system by the NSE. The turnover ratio for the year 2000-01 increased to 375, which is one of the highest in the world.

The relative importance of various stock exchanges in the market has undergone dramatic change during this decade. Century old BSE gave way to NSE in the very first year of latter's operation. The increase in turnover took place mostly at big exchanges and it was partly at the cost of small exchanges that failed to keep pace with the changes. NSE is the market leader with over 53% of total turnover (volumes on all segments) in

Table 4: Secondary Market - Selected Indicators

At the End of Financial Year	Capital Market Segment of Stock Exchanges							Turnover of Govt. Securities	Turnover of Derivatives
	No. of Brokers	No. of Listed Companies	S&P CNX Nifty	Market Capitalisation (Rs. crore)	Market Capitalisation Ratio (%)	Turnover (Rs. crore)	Turnover Ratio (%)		
1990-91	—	6,229	366.45	110,279	20.6	—	—	—	—
1991-92	—	6,480	1261.65	354,106	57.4	—	—	—	—
1992-93	—	6,925	660.51	228,780	32.4	—	—	—	—
1993-94	—	7,811	1177.11	400,077	45.6	203,703	50.9	—	—
1994-95	6,711	9,077	990.24	473,349	45.6	162,905	34.4	50,569	—
1995-96	8,476	9,100	985.30	572,257	47.0	227,368	39.7	127,179	—
1996-97	8,867	9,890	968.85	488,332	34.6	646,116	132.3	122,941	—
1997-98	9,005	9,833	1116.65	589,816	37.7	908,681	154.1	185,708	—
1998-99	9,069	9,877	1078.05	574,064	34.1	1,023,382	178.3	227,228	—
1999-00	9,192	9,871	1528.45	1,192,630	84.7	2,067,031	173.3	539,232	—
2000-01	9,792	9,922	1148.20	768,863	54.5	2,880,990	374.7	698,121	3,918

Note: Turnover figures for the respective year.

2000-01. Top 6 stock exchanges accounted for 99% of turnover, while the rest 17 exchanges for less than 1% during 2000-01. About a dozen exchanges reported nil turnover during 2000-01. The big exchanges now report higher turnover from its trading terminals in the home turf of most of the corresponding regional exchanges.

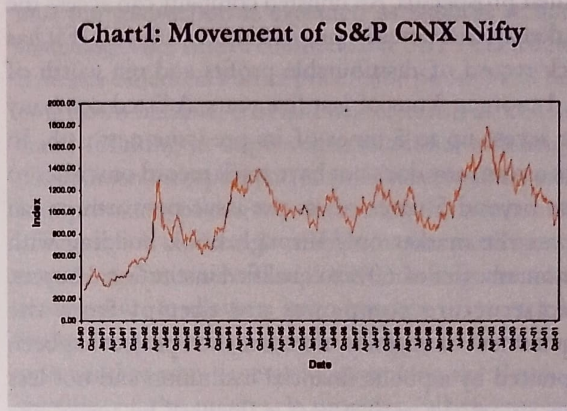
The sectoral distribution of turnover has undergone significant change over last few years. The share of manufacturing companies in turnover of top '50' companies, which was nearly 80% in 1995-96, declined sharply to less than 10% in 2000-01. During the same period the share of information technology companies in turnover increased sharply from nil in 1995-96 to 76% in 2000-01.

Trades also concentrate on a few securities/ members. The top '5' and '100' securities accounted for 52% and 98% of turnover respectively during 2000-01. During the same period, top '5' and '100' members accounted for 7.8% and 49% of turnover respectively.

Many securities listed on stock exchanges are not traded and trading in many others is negligible. The percentage of companies traded on BSE was quite low at 33.5% in April 2000, and it declined further to 26.5% in March 2001. Further, only 40.6% of companies traded on BSE were traded for more than 100 days during 2000-01. Trading took place for less than 100 days in case of 59.4% of companies traded during the year, and for less than 10 days in case of 25.9% of companies. At NSE, on an average 95% of companies available for trading were traded every month during 2000-01. Nearly 80% of companies traded on NSE were traded for more than 100 days during 2000-01. There was no trade in several companies listed on a number of regional stock exchanges. Thus trading is concentrated among only a limited number of stocks and is very thin in a large number of stocks.

The movement of the S&P CNX NIFTY, the most widely used indicator of the market, is presented in Chart 1. In the very first year of liberalisation, i.e. 1991-92, it recorded a growth of 267%, followed by sharp decline of 47% in the next year as certain irregularities in securities transactions were noticed. The market picked up next year thanks to increased inflow of foreign funds, and increased investor interest. It remained subdued till 1999-2000 when the Nifty firmed up by 42% due to the perception about strength of the Government and also its commitment towards second generation reforms, improved macro-economic parameters and better corporate results. The trend got reversed during 2000-01, which witnessed large sell-offs in new economy stocks in global markets and deceleration in the growth of the domestic economy, payment crisis on certain exchanges, large scale manipulations in stock prices and revelation of large scale corruption in the procurement of defence equipments. The trend precipitated further with suspension of repurchase facility under the UTI's 64 scheme and withdrawal of deferral products during the current fiscal.

Chart 1:



The aggregate turnover in central and state government dated securities, including treasury bills, through SGL transactions increased 12 times between 1994-95 and 2000-2001, which reported a turnover of Rs.6,98,121 crore, reflecting deepening of the market. The share of outright transactions in government securities increased from 23.2% in 1995-96 to 82% in 2000-1. The share of repo transactions declined correspondingly from 76.8% in 1995-96 to 18.1%. The share of dated securities in total turnover of government securities increased from 69% in 1996-97 to 89 in 2000-1. The T-bills accounted for remaining SGL turnover.

Derivatives Market

The monthly turnover in derivative market rose from Rs. 92 crore in June 2000 to Rs. 824 crore in June 2001. A total of 1.6 lakh contracts with a total turnover of Rs. 3,918 crore were traded during the June-March 2001. With introduction of index options from June 2001 and stock options from July 2001 and ban on deferral products in the cash market, the derivative volumes are picking up fast. September 2001 reported a total turnover of nearly Rs. 6,000 crore.

Market Design

Primary Market

Corporate Securities: The Disclosure and Investor Protection (DIP) guidelines prescribe a substantial body of requirements for issuers/intermediaries, the broad intention being to ensure that all concerned observe high standards of integrity and fair dealing, comply with all the requirements with due skill, diligence and care, and disclose the truth, whole truth and nothing but truth. The guidelines aim to secure fuller disclosure of relevant information about the issuer and the nature of the securities to be issued so that investors can take informed decisions. For example, issuers are required to disclose any material 'risk factors' and give justification for pricing in their prospectus. An unlisted company can access the market up to 5 times its pre-issue networth only if it has track record of distributable profits and net worth of Rs. 1 crore in 3 out of last five years. A listed company can access up to 5 times of its pre-issue networth. In case a company does not have track record or wishes to raise beyond 5 times of its pre-issue networth, it can access the market only through book building with minimum offer of 60% to qualified institutional buyers. Infrastructure companies are exempt from the requirement of eligibility norms if their project has been appraised by a public financial institution and not less than 5% of the project cost is financed by any of the institutions, jointly or severally, by way of loan and/or subscription to equity. The debt instruments of maturities more than 18 months require credit rating. If the issue size exceeds Rs. 100 crore, two ratings from different agencies are required. Thus the quality of the issue is demonstrated by track record/appraisal by approved financial institutions/credit rating/subscription by QIBs.

The lead merchant banker discharges most of the pre-issue and post-issue obligations. He satisfies himself about all aspects of offering and adequacy of disclosures in the offer document. He issues a due diligence certificate stating that he has examined the prospectus, he finds it in order and that it brings out all the facts and does not contain anything wrong or misleading. He also takes care of allotment, refund and despatch of certificates.

The admission to a depository for dematerialisation of securities is a prerequisite for making a public or rights issue or an offer for sale. The investors, however, have the option of subscribing to securities in either physical form or dematerialised form. All new IPOs are compulsorily traded in dematerialised form. Every public listed company making IPO of any security for Rs. 10 crore or more is required to do so only in dematerialised form.

Government Securities: RBI announces the auction of government securities through a press notification, and invites bids. The sealed bids are opened at an appointed time, and the allotment is based on the cut-off price decided by the RBI. Successful bidders are those that bid at a higher price, exhausting the accepted amount at the cut-off price. All successful bidders pay the price (yield) they bid for.

Secondary Market

Corporate Securities: The stock exchanges are the exclusive centres for trading of securities. Though the area of operation/jurisdiction of an exchange is specified at the time of its recognition, they have been allowed recently to set up trading terminals anywhere in the country. The three newly set up exchanges (OTCEI, NSE and ICSE) were permitted since their inception to have nation wide trading. The trading platforms of a few exchanges are now accessible from many locations. Further, with extensive use of information technology, the trading platforms of a few exchanges are also accessible from anywhere through the Internet and mobile devices. This made a huge difference in a geographically vast country like India.

Exchange Management: Most of the stock exchanges in the country are organised as "mutuals" which was considered beneficial in terms of tax benefits and matters of compliance. The trading members, who provide brokering services, also own, control and manage the exchanges. This is not an effective model for self-regulatory organisations as the regulatory and public interest of the exchange conflicts with private interests. Efforts are on to demutualise the exchanges whereby ownership, management and trading membership would be segregated from one another. Two exchanges *viz.* OTCEI and NSE are demutualised from inception, where ownership, management and trading are in the hands of three different sets of people. This model eliminates conflict of interest and helps the exchange to pursue market efficiency and investor interest aggressively.

Membership: The trading platform of an exchange is accessible only to brokers. The broker enters into trades in exchanges either on his own account or on behalf of clients. No stock broker or sub-broker is allowed to buy, sell or deal in securities, unless he or she holds a certificate of registration granted by SEBI. A broker/sub-broker complies with the code of conduct prescribed by SEBI. Over time, a number of brokers - proprietor firms and partnership firms - have converted themselves into corporates. Out of 9,782 brokers registered with SEBI at the end of March 2001, 3,808 brokers, accounting for nearly 39% of total, were corporate entities. At end-March 2001, there were 9,957 sub-brokers registered with SEBI. The standards for admission of members stress on factors, such as corporate structure, capital adequacy, track record, education, experience, etc. and reflect a conscious endeavour to ensure quality broking services.

Listing: A company seeking listing satisfies the exchange that at least 10% of the securities, subject to a minimum of 20 lakh securities, were offered to public for subscription, and the size of the net offer to the public (i.e. the offer price multiplied by the number of securities offered to the public, excluding reservations, firm allotment and promoters' contribution) was not less than Rs. 100 crore, and the issue is made only through book building method with allocation of 60% of the issue size to the qualified institutional buyers. In the alternative, it is required to offer at least 25% of the securities to public. The company is also required to maintain the minimum level of non-promoter holding on a continuous basis.

In order to provide an opportunity to investors to invest/trade in the securities of local companies, it is mandatory for the companies, wishing to list their securities, to list on the regional stock exchange nearest to their registered office. If they so wish, they can seek listing on other exchanges as well. Monopoly of the exchanges within their allocated area, regional aspirations of the people and mandatory listing on the regional stock exchange resulted in multiplicity of exchanges.

The basic norms for listing of securities on the stock exchanges are uniform for all the exchanges. These norms are specified in the listing agreement entered into between the company and the concerned exchange. The listing agreement prescribes a number of requirements to be continuously complied with by the issuers for continued listing and such compliance is monitored by the exchanges. It also stipulates the disclosures to be made by the companies and the corporate governance practices to be followed by them. SEBI has been issuing guidelines/circulars prescribing certain norms to be included in the listing agreement and to be complied with by the companies.

A listed security is available for trading on the exchange. 9,922 securities are listed on exchanges at the end of March 2001. The stock exchanges levy listing fees - initial fees and annual fees - from the listed companies. It is a major source of income for many exchanges. A security listed on other exchanges is also permitted for trading.

A listed company can voluntary delist its securities from non-regional stock exchanges after providing an exit opportunity to holders of securities in the region where the concerned exchange is located. An exchange can, however, delist the securities compulsorily following a very stringent procedure.

Trading Mechanism: The exchanges provide an on-line fully-automated screen based trading system (SBTS) where a member can punch into the computer quantities of securities and the prices at which he likes to transact and the transaction is executed as soon as it finds a matching order from a counter party. SBTS electronically matches orders on a strict price/time priority and hence cuts down on time, cost and risk of error, as well as on fraud resulting in improved operational efficiency. It allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. It enables market participants to see the full market on real-time, making the market transparent. It allows a large number of participants, irrespective of their geographical locations, to trade with one another simultaneously, improving the depth and liquidity of the market. It provides full anonymity by accepting orders, big or small, from members without revealing their identity, thus providing equal access to everybody. It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in entirety.

Trading Rules: Regulations have been framed to prevent insider trading as well as unfair trade practices. The acquisitions and takeovers are permitted in a well-defined and orderly manner. The companies are permitted to buy back their securities to improve liquidity and enhance the shareholders' wealth.

Price Bands: Stock market volatility is generally a cause of concern for both policy makers as well as investors. To curb excessive volatility, SEBI has prescribed a system of price bands. The price bands or circuit breakers bring about a coordinated trading halt in all equity and equity derivatives markets nation-wide. An index-based market-wide circuit breaker system at three stages of the index movement either way at 10%, 15% and 20% has been prescribed. The movement of either S&P CNX Nifty or Sensex, whichever is breached earlier, triggers the breakers. As an additional measure of safety, individual scrip-wise price bands of 20% either way have been imposed for all securities except those available for stock options.

Demat Trading: While the investors have a right to hold securities in either physical or demat form, SEBI has mandated compulsory trading and settlement of securities in select securities in dematerialised form. All investors are required to mandatorily trade in dematerialised form in respect of 2,335 securities as at end-June 2001. All actively traded securities are held, traded and settled in demat form.

The securities of public limited companies are freely transferable subject to certain exceptions. Two depositories, *viz.* NSDL and CDSL, maintain ownership records of dematerialised securities in a book entry form and transfer ownership of securities electronically without making the securities move from person to person. At the end of June 2001, 39,948 million securities worth Rs. 3,265 billion have been dematerialised with NSDL. The market capitalisation of the companies that have joined NSDL has reached Rs. 5,398 billion at the end of June 2001. 202 depository participants are rendering depository services at 2,639 locations all over the country serving 4 million investors who have opened beneficial accounts with NSDL. The securities of 3,154 companies are available for demat trading. Demat settlement accounts for over 99% of turnover settled by delivery. This has almost eliminated the bad deliveries and associated problems.

Charges: A stock broker is required to pay a registration fee of Rs.5, 000 every financial year, if his annual turnover does not exceed Rs. 1 crore. If the turnover exceeds Rs. 1 crore during any financial year, he has to pay Rs. 5,000 plus one-hundredth of 1% of the turnover in excess of Rs.1 crore. After the expiry of five years from the date of initial registration as a broker, he has to pay Rs. 5,000 for a block of five financial years. Besides, the exchanges collect transaction charges from its trading members. NSE levies Rs. 4 per lakh of turnover.

The maximum brokerage a trading member can levy in respect of securities transactions is 2.5% of the contract price, exclusive of statutory levies like SEBI turnover fee, service tax and stamp duty. However, brokerage charges as low as 0.15% are also observed in the market.

Trading Cycle: The trades accumulate over a trading cycle and at the end of the cycle, these are clubbed together, and positions are netted and payment of cash and delivery of securities settle the balance. In respect of 414 securities, which are traded and settled under rolling settlement, the trading cycle comprises one day and transactions in these securities are settled after 5 days from the trade date w.e.f. July 2001. The balance securities are traded and settled under uniform weekly settlement cycle. The market also had a variety of deferral products like modified carry forward system, which permitted leveraged trading by enabling postponement of settlement. These have been banned and the market has moved close to spot/cash market.

Risk Management: To pre-empt market failures and protect investors, the regulator/exchanges have developed a comprehensive risk management system, which is constantly monitored and upgraded. It encompasses capital adequacy of members, adequate margin requirements, limits on exposure and turnover, indemnity insurance, on-line position monitoring and automatic disablement, etc. They also administer an efficient market surveillance system to curb excessive volatility, detect and prevent price manipulations. Exchanges have set up trade/settlement guarantee funds for meeting shortages arising out of non-fulfillment/partial fulfillment of funds obligations by the members in a settlement. A clearing corporation assures the counterparty risk of each member and guarantees financial settlement in respect of trades executed on NSE.

Government Securities: The secondary market for government securities is wholesale in nature, with most deals negotiated on telephone. The WDM segment of NSE provides a screen-based order-driven trading platform for trading of a wide range of government securities. Many of the negotiated deals are reported on this segment. RBI is setting up a Negotiated Dealing System, which will facilitate electronic bidding in auctions and secondary market transactions in government securities. RBI provides SGL account facilities to large banks and FIs to hold government securities in dematerialised form and follows a DvP style system for settlement of transactions.

Derivatives Market

The enabling legislation for derivatives trading came through in early 2000. This defined derivatives to include: (a) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security, and (b) a contract which derives its value from the prices, or index of prices, or underlying securities. Derivatives are legal and valid only if such contracts are traded on a recognised stock exchange, thus precluding OTC derivatives.

SEBI permitted the derivative segments of two stock exchanges, i.e. NSE and BSE, and their clearing house/corporation to commence trading and settlement in approved derivative contracts. To begin with, SEBI approved trading in index futures contracts based on S&P CNX Nifty Index and BSE-30 Index. This was followed by approval for trading in options based on these two indices and options on individual securities. The trading in index futures commenced in June 2000,

Table 5: Contract Specification for Derivatives at NSE

Particulars	Index Futures	Stock Futures (Proposed)	Index Options	Stock Options
Security Description	N FUTIDX NIFTY	N FUTSTK	N OPTIDX NIFTY	N OPTSTK —
Underlying	S&P CNX Nifty Index	Individual Securities	S&P CNX Nifty Index	Individual Securities
Style of Option	NA	NA	European	American
Contract Size	200 or multiples therof (minimum value of Rs. 2 lakh)	multiples of 100, as may be specified by NSE	200 or multiples therof (minimum value of Rs. 2 lakh)	multiples of 100, as may be specified by NSE
Price Steps	Rs. 0.05			
Expiration Months	3 near months			
Trading Cycle	A maximum of three month trading cycle - the near month (one), the next month (two) and the far month (three). New contract is introduced on the next trading day following the expiry of near month contract			
Last Trading/Expiration Day	Last Thursday of the expiry month or the preceding trading day, if last Thursday is a trading holiday			
Price Bands	NA			
No. of Strike Prices	NA	NA	Minimum of 5 (two 'in the money', one 'at the money' and two 'out of the money') for every option type (i.e. call and put)	Minimum of 5 (two 'in the money', one 'at the money' and two 'out of the money') for every option type (i.e. call and put)Strike
Strike Price Interval (in Rs.)	NA	NA	20	Between 5 and 100 depending on the price of underlying
Settlement	In cash on T+1 basis	In cash on T+1 basis	In cash on T+1 basis	Daily settlement on T+1 basis and final settlement on T+3 basis
Daily Settlement Price	Closing price of futures contract	Closing price of futures contract	Premium Value (net)	Premium Value (net)
Final Settlement Price	Closing value of index on expiry day	Closing value of securities on expiry day	Closing value of index on expiry day	Closing price of underlying on exercise day or expiry day
Settlement Day	Last trading day			

NA: Not applicable
Source: NSE.

index options in June 2001 and stock options in July 2001. The market design for these products traded on NSE are presented in Table 5.

Regulatory Framework

The four main legislations governing the securities market are: (a) the SEBI Act, 1992 which establishes SEBI to protect investors and develop and regulate securities market; (b) the Companies Act, 1956, which sets out the code of conduct for the corporate sector in relation to issue, allotment and transfer of securities, and disclosures to be made in public issues; (c) the Securities Contracts (Regulation) Act, 1956, which provides for regulation of transactions in securities through control over stock exchanges; and (d) the Depositories Act, 1996 which provides for electronic maintenance and transfer of ownership of demat securities.

Government have framed rules under the SCRA, SEBI Act and the Depositories Act. SEBI has framed regulations under the SEBI Act and the Depositories Act for registration and regulation of all market intermediaries, and for prevention of unfair trade practices, insider trading, etc. Under these Acts, Government and SEBI issue notifications, guidelines, and circulars which need to be complied with by market participants. The SROs like stock exchanges have also laid down their rules of game.

The responsibility for regulating the securities market is shared by Department of Economic Affairs (DEA), Department of Company Affairs (DCA), Reserve Bank of India (RBI) and SEBI. The activities of these agencies are co-ordinated by the High Level Committee on Capital Markets. Most of the powers under the SCRA are exercisable by DEA while a few others by SEBI. The powers of the DEA under the SCRA are also con-currently exercised by SEBI. The powers in respect of the contracts for sale and purchase of securities, gold related securities, money market securities and securities derived from these securities and ready forward contracts in debt securities are exercised concurrently by RBI. The SEBI Act and the Depositories Act are mostly administered by SEBI. The rules and regulations under the securities laws are administered by SEBI. The powers under the Companies Act relating to issue and transfer of securities and non-payment of dividend are administered by SEBI in case of listed public companies and public companies proposing to get their securities listed. The SROs ensure compliance with their own rules as well as with the rules relevant for them under the securities laws.

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