

Equity Markets

Chitra Ramkrishna and Madhu Sudan Sahoo

Indian equity markets have a long history. For a few decades (1950–80), the government had an almost controlling role in them. Since then, however, gradual easing of regulations helped the markets grow and mature. This chapter points out some of the significant steps taken in this process and examines the recent trends and the current state of the Indian equity markets. After a general overview to define the scope of the securities markets in India, the chapter lays out the important aspects and developments in the design and outcomes of, first the primary market where securities originate and then, of the secondary markets where they are traded. Then the chapter turns to more qualitative aspects of the market, describing the various systems in place to protect investor interests and to improve and certify the competence of both investment professionals and the general public.

INTRODUCTION

Transfer of resources from those with surplus resources to others who have a productive need for them is perhaps most efficiently achieved through the 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 save and invest respectively, which inevitably enhances savings and investments in the economy. Further, the securities markets channel the savings to the most productive investments, which inevitably increases the rate of return on investments. The securities

market thus fosters economic growth by augmenting real savings and capital formation, and also by raising the productivity of investments by improving allocation of investible funds.

The securities market is a component of the capital market which enables pooling of long-term and intermediate-term resources for capital formation. It is, however, that component which covers only those forms of pooling of resources that are evidenced by transferable instruments, called securities; it links savings to investments through securities; it enables exchange of securities among savers and investors for funds. There is one set of economic units that demands securities in lieu of funds and another set that supplies securities for funds. The supply of securities comes from those who wish to invest but do not have adequate resources. They create and exchange securities for funds. The demand for securities comes from those who generally have surplus budgets, but do not have use for them. They exchange funds for securities. The demand for securities is equal to the supply of funds and the supply of securities is equal to the demand for funds. The demand for and supply of securities and funds determine the prices of securities; the efficiency of price discovery depends on the conditions in goods and securities markets.

The law defines securities as that which includes 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 issued by any collective investment scheme, units of mutual funds (MFs), security receipts, securitization instruments, and such other instruments so declared by the central government and rights and interest in securities. It is not an inclusive, exclusive, or exhaustive definition. Instruments which are not *securities* today under the law can be treated as securities if the government so deems in the changed market environment. However, no such instruments have ever been declared by central government to be securities. As an asset class, the securities are unique because they do not have any intrinsic value or physical shape. Their value is contingent upon so many factors—the fluctuations in value often defy logic. These instruments have nothing in common except the insecurities associated with all of them.

The units in need of funds are individuals, corporations, institutions, and governments. They raise funds from the securities market and elsewhere to meet their needs. Similarly, the units which supply funds are individuals, corporations, institutions, and governments. They supply funds through securities markets and otherwise to meet their investment needs. These units create and exchange securities for funds to meet their needs and use non-securities markets for the balance. While the corporate sector and the

governments are major suppliers of securities for funds, individuals are the major suppliers of funds for securities. Institutions generally raise funds and/or invest in securities for and on behalf of these units. While corporates issue mostly equity shares (equity in common parlance) and debentures, governments issue debt instruments to raise resources. Individuals, directly or through institutions, invest in shares and debt instruments. The equity shares and debt instruments are predominant and basic forms of securities. Other securities, such as units of mutual funds and futures are derivatives of different orders of these two forms of securities.

Equity is the most popular form of securities, particularly in India. It represents the interest of shareholders in a company. The interest takes the form of a share in profit if the company performs well, a share in the assets on winding up of the company, and a share in the control of the company. These shares are generally residual interests and hence are uncertain, making equity the most risky of the securities. In the interest of equity, the uncertainty is compensated by the potential for high returns which accrue from valuation of equities. The investors, therefore, wish the equity prices to go up continuously. Some unscrupulous participants manipulate these prices to make abnormal gains. These characteristic features of securities, particularly of equities, call for a sophisticated regulatory framework to deal with their issue and trading, with a view to preserving market integrity and protecting the interests of investors. This chapter presents an overview of the market design in vogue at the end of March 2008, and the market outcome in the organized market for equities in India, since 1992 when major reforms were initiated.

Profile of Markets

The securities market in India dates back to the 18th century when the securities of the East India Company were traded in Mumbai and Kolkata. Brokers used to gather under a Banyan tree in Mumbai and under a *Neem* tree in Kolkata for the purpose. However, the real beginning of the market came in the 1850s with the emergence of joint stock companies with limited liability. The 1860s witnessed feverish dealing in securities and reckless speculation. This brought brokers in Mumbai together in July 1875 to establish the first formally organized stock exchange in India, namely the Bombay Stock Exchange Limited. The Ahmedabad Stock Exchange started in 1894 and 22 other exchanges followed in the 20th century.

The recent past, particularly since massive liberalization launched in 1991, has been in many ways remarkable for the securities market in India. It has grown exponentially as measured in terms of the amount of funds raised from the market, number of market participants, the number of listed stocks, market capitalization, trading volumes and turnover on stock exchanges, and investor population. The figures (see Table 2.1) relating to the financial year 2007–08 bear testimony to such growth. The government and the corporate sector together raised a sum of Rs 5.78 trillion from the market. Indian companies raised about Rs 0.27 trillion through euro issues. Mutual funds mobilized net resources of about Rs 1.84 trillion, twice the incremental bank deposits. The assets at their disposal increased to Rs 5.05 trillion at the end of March 2008. The net cumulative investment by foreign institutional investors (FIIs) stood at US\$68 billion on the same date. The equity of companies listed on exchanges reached a valuation of about USD 2 trillion in early 2008, which far exceeded the total deposits with the banking system in the country and was double of the Gross National Product (GNP). The exchanges reported a turnover of Rs 51.31 trillion in the cash segments and Rs 133.33 trillion in the derivative segments, while the subsidiary general ledger reported a total turnover (outright transactions) of Rs 33.42 trillion in government securities during the year. The open interest in derivatives at the end of March 2008 reached Rs 0.49 trillion. The exchanges have settlement guarantee funds which can meet the settlement obligations for four to five consecutive settlements even if all the trading members default in their obligations. The trading costs reduced from 114 basis points in 2000 to 53 basis points in 2006. Depositories had a total of 14.2 million investor accounts at the end of March 2008. On the same date, there were 8 million clients registered with the NSE for undertaking transactions in cash (7.98 million) and derivative (6.99 million) segments. An estimated 32 million investors transact in securities markets.

Three main sets of entities depend on the securities market. While corporates and governments raise funds from the securities market to meet their investment needs and/or to discharge some obligations, households invest their savings in securities. Along with an increase in fiscal deficits of governments, the dependence on market borrowings to finance fiscal deficits has increased over the years. State governments and the central government financed about 14 percent and 18 percent of their fiscal deficits respectively through market borrowings during 1990–91. In percentage terms, dependence of the state governments on market borrowings did not increase much till 2000–01. However, during 2003–04 their dependence on market borrowing increased to 38 percent. In the case of the central government, dependence on market borrowing increased to 103 percent by

Table 2.1: A Profile of Indian Securities Markets

Description	Unit	1991-92	1995-96	2000-01	2007-08
Amount Raised by Government	Rs billion	122.84	467.83	1284.83	2559.84
Amount Raised Domestically by Corporate Sector	Rs billion	163.66	361.93	741.99	2964.32
Amount Raised through Euro Issues	Rs billion	0	12.97	41.97	265.56
Amount Raised by Mutual Funds	Rs billion	112.53	-58.33	111.35	1538.02
Assets under Management of Mutual Funds at the end of year	Rs billion	379.73	743.15	905.87	5051.52
Market Capitalization at the end of year	Rs billion	3541.06	5722.57	7688.63	5143.68
Turnover in Cash Segment	Rs billion	340.30	2273.68	28809.90	51308.16
Impact Cost (for a trade of Rs 0.5 crore at NSE)	%	—	0.75	0.28	0.09
Trading Costs	Basis Points	NA	NA	114	53
Turnover in Derivatives Segment	Rs billion	0	0	40.18	133327.87
Open Interest in Derivatives at the end of year	Rs billion	—	—	0.4917	489.74
Net Cumulative Investment by FIIs at the end of Year	US \$ billion	0	5.2	13.4	68.9
No. of Investor Accounts with Depositories at the end of year	million	0	0	3.8	14.2
Amount of Equity Demat Settlement	Rs billion	—	—	2687.36	18,038.46
No. of Investors (in Equity, Debt, and Mutual Funds)	million	NA	NA	32.21	NA

Source: SEBI and RBI.

2007–08. The central government and the state governments now finance about 100 percent and 60 percent of their fiscal deficits, respectively through borrowings from the securities market. The corporate sector finances about one-third of its external finance requirements through the securities market (see Table 2.2).

Table 2.2: Dependence on Securities Markets

Year	Share (%) of securities markets in			
	External finance of corporates	Fiscal deficit of central government	Fiscal deficit of state governments	Financial savings of households
1991–92	19.17	20.7	17.5	22.9
1992–93	33.38	9.2	16.8	17.2
1993–94	53.23	48.0	17.6	13.9
1994–95	44.99	35.2	14.7	12.0
1995–96	21.67	56.4	18.7	7.7
1996–97	21.83	30.0	17.5	7.0
1997–98	27.85	36.5	16.5	4.5
1998–99	27.49	60.9	14.1	4.1
1999–00	33.63	67.1	13.8	8.4
2000–01	30.17	61.8	14.0	5.8
2001–02	38.71	64.4	17.7	8.3
2002–03	–17.99	71.8	27.9	1.1
2003–04		72.1	38.4	0.1
2004–05		40.5	30.0	1.1
2005–06		72.6	17.0	5.1
2006–07		80.5	16.8	9.0
2007–08		102.9	58.9	12.4

Source: Center for Monitoring Indian Economy (CMIE) and Reserve Bank of India (RBI).

The household sector accounted for 64.6 percent of gross domestic savings during 2007–08; and 48.1 percent of their savings were in financial assets. The share of financial savings of the household sector in securities (shares, debentures, public sector bonds, units of Unit Trust of India (UTI), and other MFs and government securities) is estimated to have gone down from 22.9 percent in 1991–92 to 12.4 percent in 2007–08.

Market Participants

It is not that the suppliers of funds and the suppliers of securities meet each other and exchange funds for securities. It is difficult to accomplish such double

coincidence of wants. The amount of funds available from the supplier of funds may not be the amount needed by the supplier of securities. Similarly, the risk, liquidity, and maturity characteristics of the securities may not match the preference of the supplier of funds. In such cases, suppliers of funds and of securities incur substantial search costs to find each other. Search costs are minimized by intermediaries who match and bring these suppliers together. They may act as agents to match the needs of the suppliers of funds/securities, help them in creation and sale of securities or buy the securities issued by suppliers of securities and in turn sell their own securities to suppliers of funds. It is thus a misnomer that the securities market *disintermediates* by establishing a direct relationship between the suppliers of funds and the suppliers of securities. The market does not work in a vacuum; it requires the services of a large variety of intermediaries such as merchant bankers and brokers to bring the suppliers of funds and the suppliers of securities together for a variety of transactions. 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 suppliers of funds/securities (issuers of securities and investors in securities), and not by the intermediaries. This provides the underpinning for regulation and supervision of intermediaries by a regulator.

The intermediaries, issuers, and investors need certain infrastructure to support transactions. A number of institutions, such as exchanges, depositories, clearing corporations (CCs), information technology and the like companies, provide the required infrastructure. The securities market thus has essentially four categories of participants, namely, the issuers of securities, the investors in securities, the intermediaries, and a few institutions or service providers.

At the end of March 2008, there were 19 recognized stock exchanges and 9,487 registered brokers in India. Two exchanges, namely NSE and BSE, which had 1,129 and 946 brokers respectively, accounted for 99.99 percent of turnover during 2007–08. The top 100 brokers of each of these two exchanges account for about three-fourths of the turnover on cash segments. Thus, the *raison d'être* of the other 17 exchanges and their associated 7,500 brokers has disappeared. A vast majority of brokers on the NSE and the BSE have marginal existence.

The continued existence of defunct exchanges and business-less brokers presents a classic case of market failure and state failure. Other participants and intermediaries in the securities market have similar excess capacity and present similar failure. It is market failure because the economic agents have not closed their shops even though they have no business. It is state failure because the government has not instigated the closure of defunct participants. This continuity-at-whatever-cost approach is adding to moral hazard and

regulatory cost. Incidentally, these are the institutions which profess efficient allocation of resources. Hastening the exit of the defunct entities assumes importance both for the sake of better resource use, as well as for reducing the regulatory cost.

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. The law and custom, often enforced by the regulator, provide this reassurance. The regulator develops fair market practices and regulates the conduct of the issuers of securities and the intermediaries, so as to protect the interests of the investors in securities. The regulator ensures a high standard of service from the intermediaries and the supply of quality securities and non-manipulated demand for them in the market, so that the issuers and the investors are able to undertake more transactions with ease, efficiency, and security.

Investor Population

Securities and Exchange Board of India (SEBI) and National Council of Applied Economic Research (NCAER) have been carrying out investor surveys at intervals since 1986. They report the estimated number of households and individuals with investments in equity shares and/or debentures. More recent surveys report separate information for mutual funds and break-up of investors by urban or rural locations. According to an NCAER survey, an estimated 1.66 million or 1 percent of all Indian households had invested in securities in 1986. SEBI survey reported that an estimated 3.99 million or 2.5 percent of households had invested in securities in 1991. The first SEBI-NCAER Survey of Indian investors conducted in early 1999 revealed that an estimated 12.8 million or 7.6 percent of all Indian households, representing 19 million individuals had directly invested in equity shares and/or debentures, at the end of the financial year 1998-99. According to the second SEBI-NCAER Survey conducted in late 2000, 13.1 million or 7.4 percent of all Indian households, representing 19.5 million individuals, had directly invested in equity shares and/or debentures during the financial year 2000-01. The investor households increased by 0.3 million while the number of investors increased by 0.5 million between 1998-99 and 2000-01.

An estimated 15 million households (nearly 9 percent), representing at least 23 million unit holders, had invested in units of MFs in 1998-99, according to the first SEBI-NCAER Survey. There were 11.8 million households

(nearly 7 percent), representing 19 million unit holders, who had invested in units of MFs in 2000–01, according to the second SEBI–NCAER Survey.

The SEBI–NCAER Surveys estimated the number of investors in equity and debentures and the number of investors in units of MFs separately. Since equities, debentures, and units of MFs are the most common forms of securities, the numbers can be combined to ascertain the total number of investors in these securities. Taking the data all together, an estimated 21 million, or nearly 12 percent of all Indian households representing 32 million individuals, had invested in equity shares, debentures, and/or units of MFs at the end of financial year 2000–01. The summary findings of various estimations are presented in Table 2.3. It may be noted that these surveys did not include investors in non-listed securities, government securities, or institutional investors.

Besides these individual investors, a large variety and number of institutions and corporates, namely mutual funds, financial institutions, and FIIs also participate in India's securities market. A scheme for attracting portfolio investment from FIIs has been in place since September 1992. Under this scheme, they are allowed to invest in all securities, including units of MFs and government securities, and in both primary and secondary markets. An individual FII/sub-account is allowed to invest up to 10 percent of the issued and paid-up capital in a company. The aggregate investment by all FIIs should not exceed 24 percent of the issued and paid-up capital in a company. This limit could be increased up to the sectoral cap/statutory ceiling, as applicable, with the approval of the company concerned. FIIs are also allowed to invest up to US\$5 billion in government securities and US\$3 billion in corporate debt. They are also allowed to invest in exchange traded derivatives subject to certain position limits. At the end of March 2008, 1,319 FIIs were registered with SEBI. They had a net cumulative investment of Rs 2.72 trillion in equities and Rs 0.19 trillion in debt. On the same date, there were 40 mutual funds with assets under management of Rs 5.05 trillion in 956 schemes.

Institutions

SEBI

India embraced economic liberalization in a meaningful sense from the early 1990s. It essentially meant freedom for economic agents to decide the product that they wanted to produce and for the market to discover the quantity

Table 2.3: Investor Population

Investments in	1986	1990	1998-99 (SEBI-NCAER)			2000-01 (SEBI-NCAER)		
	(NCAER)	(SEBI/SCMRD)	Urban	Rural	Total	Urban	Rural	Total
Number of Households with investments in Equity/Debentures/Mutual Funds (million)								
Equity (E)		3.8	8.30	3.80	12.10	4.62	1.92	6.54
Debentures (D)		2.9	2.96	0.74	3.70	5.28	4.27	9.55
$E \cap D$		2.7	2.40	0.59	2.99	2.10	0.91	3.01
$E \cup D$	1.66	4.0	8.83	3.98	12.81	7.80	5.28	13.08
Units of MFs (MF)					15.05	7.04	4.74	11.78
$(E \cup D) \cap MF$						2.51	1.33	3.85
$(E \cup D) \cup MF$						12.33	8.68	21.01
Number of Investors with Investments in Equity/Debentures/Mutual Funds (million)								
Equity (E)	9.00		12.22	5.73	17.95	6.93	2.80	9.73
Debentures (D)			4.36	1.12	5.49	7.92	6.23	14.15
$E \cap D$			3.53	0.89	4.43	3.15	1.33	4.48
$E \cup D$	10.00		13.05	5.96	19.01	11.7	7.7	19.5
Units of MFs (MF)					23.0	11.35	7.65	19.0
$(E \cup D) \cap MF$						4.05	2.14	6.19
$(E \cup D) \cup MF$						19.01	13.20	32.21

Source: SEBI-NCAER Surveys.

and price. However, in order to avoid market failure—a strong possibility in the face of information asymmetry and externalities—it was considered necessary to create a statutory agency which would ensure fair play in the market, develop fair market practices, and prescribe and monitor conduct of issuers and intermediaries, so that the securities market enables an efficient allocation of resources. The statutory agency, known as the regulator in common parlance, came up to discharge these responsibilities on behalf of the government.

The SEBI Act, 1992, established the SEBI and assigned it responsibility for (a) protecting the interests of investors in securities, (b) promoting the development of the securities market, and (c) regulating the securities market. The Act has been amended a number of times subsequently to empower SEBI adequately and to expand its jurisdiction to meet emerging needs. Its regulatory jurisdiction extends over corporates in the issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with the securities market. All market intermediaries are registered and regulated by SEBI. They are also required to appoint a compliance officer who is responsible for monitoring compliance with securities laws and for the redressal of investor grievances. The courts have upheld the powers of SEBI to impose monetary penalties and to levy fees on market intermediaries.

SEBI is not only a regulator, but also has the additional responsibilities of developing the market and protecting the interests of investors in securities. These responsibilities are traditionally discharged by government. It has powers—legislative, executive, and judicial—similar to that of the government. Bodies like SEBI are neo-governments, that is, governments within the government, and they carry out governance on behalf of the government in a pre-defined framework. They are epistemically called *regulators*, as their responsibilities include regulation. In view of the general perception that SEBI is a regulator, SEBI focuses most of its efforts on regulation and its performance is assessed in terms of its regulatory achievements.

Exchanges

Stock Exchange is an organized marketplace where trading members—commonly known as brokers—gather around a trading pit or access an electronic trading platform to trade in stocks and other securities either as agents for clients, or as principals on their own accounts. The core activities of an exchange, therefore, are (a) maintaining an orderly trading platform, (b) permitting securities that can be traded on the platform, (c) admitting

the brokers who can trade on the platform, (d) clearing and settling trades executed on the platform, (e) and maintaining discipline on issuers of securities and on the brokers and thereby on the market. They occupy a prime and elite position among the varied institutions of capitalism.

The law does not require trading of securities to take place only on exchanges. However, for obvious reasons, most of the trades in listed equities take place on exchanges. The trades taking place outside exchanges are called off-market transactions or over-the-counter transactions. Authentic data about such transactions is not available. Brokers undertaking off-market transactions are, however, required to report the same to the exchanges.

Clearing Corporations

The Securities Contract (Regulation) Act (SCRA), enacted in 1956, dealt with the trading of securities and the governance of exchanges. It considered clearing and settlement (C&S) an integral part of trading. The members of the exchanges, called brokers, acted as trading-cum-clearing members. They knew each other and traded and settled trades among themselves. The SCRA did not explicitly provide for C&S, which was left to the byelaws of the exchanges. The byelaws generally provided for clearing houses, and the exchanges traditionally set-up departmental clearing houses to facilitate settlement. However, with the advent of the anonymous screen-based trading system, which does not allow participants to assess the counterparty risk of others, and in the interest of better risk management through innovation and counterparty guarantee, the modern markets started using the services of a CC for clearing and settlement. Besides, unbundling of activities made economic sense with the exchanges and CCs specializing in trading and clearing respectively. While many exchanges modified the structural design of the clearing house to address emerging concerns, NSE set up a wholly owned subsidiary to provide clearing and settlement services. It, however, continued to have trading-cum-clearing membership, which allowed brokers to trade on the exchange and settle the trades through CC. Its byelaws suitably provided for use of CC for clearing and settlement of its trades. Thus, both models of clearing and settlement, namely Clearing Houses and Clearing Corporations, are in use today within the extant legal framework in the cash segments of exchanges.

The Securities Laws (Amendment) Act, 2004, enacted on January 7th, 2005, provided that an exchange may, with the approval of SEBI, transfer the duties and functions of a clearing house to a recognized CC for the purpose of the periodical settlement of contracts and differences thereunder, and

the delivery of, and payment for, securities. It obliges SEBI to approve such transfer, if it is in the public interest, or in the interest of the trade. It further ensures that only a company can be recognized as a CC and its byelaws need to be approved by SEBI. Government and SEBI are in the process of framing rules to recognize and regulate CCs.

Depositories

India has a well-developed depository system backed by modern legislation. The Depositories Act, 1996, provides for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed, accuracy, and security. This is done by (a) making securities of public limited companies freely transferable, subject to certain exceptions, (b) dematerializing the securities in the depository mode, and (c) providing for maintenance of ownership records in a book entry form. The Act envisages transfer of ownership of securities electronically by book entry, without making the securities move from person to person. In order to promote dematerialization, the regulator mandated trading and settlement in demat form in an ever-increasing number of securities in a phased manner. The stamp duty on transfer of demat securities was waived. Two depositories, namely, NSDL and CDSL, provide instantaneous electronic transfer of securities. This has eliminated bad deliveries and associated problems.

To prevent physical certificates from sneaking into circulation, SEBI has made it mandatory for all new Initial Public Offerings (IPOs) to be traded in dematerialized form since year 2000. The admission to a depository for dematerialization of securities has been made a prerequisite for making a public or Rights Issue, or an offer for sale. Rights Issue is the issuing of rights to a company's existing shareholders in order to buy a proportional number of additional securities at a given price (usually at a discount) within a fixed period. The investors, however, have the option of subscribing to securities in either physical form or dematerialized form. It has also been made compulsory for public listed companies making IPO of any security for Rs 100 million or more to do the same, in dematerialized form only.

Ownership of Institutions

Foreign investment is permissible in infrastructure companies in securities markets, namely, stock exchanges, depositories, and clearing corporations. The salient features of the policy allowing foreign investment in these companies are as under:

1. Foreign investment up to 49 percent is allowed in these companies, with a separate Foreign Direct Investment (FDI) cap of 26 percent and a Foreign Institutional Investment (FII) cap of 23 percent.
2. FDI is allowed with specific prior approval of FIPB.
3. FII is allowed only through purchases in the secondary market.
4. FII are not allowed to seek and get representation on the Board of Directors.
5. No foreign investor, including persons acting in concert, can hold more than 5 percent of the equity in these companies.

Subsequent to the issuance of the said policy in 2006 Indian markets have witnessed a plethora of foreign investments in the stock exchanges. The said policy has also opened the doors for strategic investments by foreign stock exchanges in their Indian counterparts.

Associations of Intermediaries

As stated earlier, there are a large number and variety of intermediaries operating in the market. The SEBI Act empowers SEBI to register and regulate intermediaries listed in the Act, and also such other intermediaries who may be associated with the securities market in any manner. This provision allows SEBI to regulate, without amending the law, intermediaries that are not listed in the Act, if such a need arises in future, as well as, new intermediaries that may emerge in future. About 60,000 intermediaries were registered with SEBI at the end of March 2008. These include sub-brokers (44,073), cash market brokers (9,487), derivative brokers (1,442), FIIs (1,319), depository participants (654), and portfolio managers (205).

The intermediaries, like brokers and sub-brokers, are also registered with exchanges. The exchanges were originally associations of persons formed by brokers. Hence, the exchanges acted as self-regulatory organizations for brokers. Even after their demutualization and corporatization, the exchanges continue to regulate the conduct of brokers and sub-brokers.

The Union Budget for 2007–08 proposed to take forward the idea of self-regulating organizations (SROs) for different market participants under regulations to be made by SEBI and if necessary, supported by an enabling law. The SEBI Act mandates SEBI to promote SROs. It has been taking steps to promote the development of SROs in the Indian securities market. In pursuance of this, it has framed regulations for SROs.

There is no SRO as such in the Indian securities market, as yet. Mutual funds, merchant bankers, share transfer agents, debenture trustees, depository participants have associations which are currently acting as trade bodies

and promoting the interests of members. SEBI has been encouraging trade bodies and intermediaries' associations of stock brokers, mutual funds, merchant bankers, and depositories to develop their respective self-regulatory organizations. The stock brokers' association, Association of National Exchanges Members of India (ANMI), has evinced interest to become an SRO for stock brokers.

PRIMARY MARKET DESIGN

The primary market provides the channel for sale of new securities. The issuers of securities issue (create and sell) new securities in the primary market to raise funds for investment and/or to discharge some obligations. This is done either through a public issue, or private placement. It is called a public issue when anybody can subscribe to 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 the offer or invitation to subscribe to securities is made to 50 or more persons. This means that an issue offered to less than 50 persons is a private placement. If the securities are issued exclusively to existing shareholders, it is called a *rights* issue. It is a public issue if the offer is made to the public at large. The securities are issued at face value, or at a discount or premium.

A variant of the primary market allows the existing shareholders of a company to offer securities to the public for subscription through an offer document. This is called an Offer for Sale. This route is generally used by the government for disinvestment of its shares in Public Sector Undertakings (PSUs). Another variant allows a company to buy back its securities. The companies buy back securities from the existing security holders on a proportionate basis through a tender offer, from the open market through book building process, or through stock exchanges. Still another variant allows a person to acquire shares or voting rights in excess of a certain percent through a public announcement/offer to do so with a view to take over or delist a company.

Disclosure-based Regulation

The availability of relevant information about products (goods and services) and their suppliers greatly enhances market efficiency, as it enables the users

of the products to take informed decisions. The availability of information is generally ensured by casting a duty on the suppliers to disclose certain information about themselves and their products. At times it is supplemented by conferring a right on the users to demand and obtain the information from the suppliers. This kind of regulation, which provides for the availability of information through disclosure by the suppliers on their own or on demand from the user, is called Disclosure-Based Regulation (DBR).

In the context of the securities market, disclosure relates to information about the products, namely the securities and the services of the intermediaries and their suppliers, namely the issuers of securities and the intermediaries. Such information enables an investor to decide whether to undertake transactions in the securities market, and if so, in which securities and at what prices and through which intermediary. It similarly enables an issuer to decide whether to raise resources through the securities market, and if so, through what instruments and which intermediary.

India adopted disclosure-based regulation in 1992. Under the old, merit-based approach, the regulator takes decisions on behalf of investors and issuers. It reviews each transaction according to its perceived merits. This approach assumes that the regulator is better equipped than investors or issuers and can decide the merits of a transaction better on their behalf. However, the merit-based approach has severe limitations in the securities market, which suffers from moral hazard and adverse selection associated with the asymmetry of information.

In contrast, disclosure-based regulation assumes that the market, rather than the regulator, is best equipped to determine the merits of a transaction. Under this approach the regulator ensures disclosure of full and accurate information, based on which investors or issuers take informed decisions, and also, assume responsibility for their own decisions. DBR believes that the regulator cannot take decisions for investors and issuers, but it can protect them by arming them with information they need in order to take decisions. The investors and issuers like DBR because it gives them the freedom to take their own decisions. The regulators like it because they are reluctant to be accountable for the decisions they take for, or on behalf of, issuers and investors. Finally, the issuers and intermediaries like it because it is not as ideologically threatening or as costly to comply with—particularly with the availability of technology—as substantive mandates.

In general, securities markets suffer from information asymmetry between the issuers, the intermediaries, and the regulator on one hand, and the investors and the issuers on the other hand. DBR mitigates this information asymmetry and thereby (a) improves allocative efficiency, as the investors

and issuers get better information about the market and can make more informed decisions; (b) enhances equity as all the investors and issuers have equal access to the information necessary for making decisions, and no one benefits from the information exclusively or at the cost of others; (c) promotes transparent governance and prevents fraud and corruption; and (d) improves performance of the disclosing parties as they know that their performance is being watched and evaluated.

DBR changes the behavior of the disclosers, that is the issuers, intermediaries, and regulators, and the users, that is the issuers and investors, or both. First, the disclosers provide, either of their own volition or in compliance to some regulatory mandate, certain information about themselves, their activities, and their products. The users gather the information, and if warranted, change their behavior with respect to the discloser, or his product. As a result of the change in the behavior of the users, the behavior of the discloser also changes. The discloser also reveals his changed behavior which, in turn, induces further changes in the behavior of the user. The process continues ad infinitum and the market benefits from the combined changes in the behavior of the users and the disclosers in the desired policy direction.

ICDR Regulations

A major part of the liberalization process was the repeal of the Capital Issues (Control) Act, 1947, in May 1992. In addition to ending the merit-based approach to regulation, repeal of the Act ended the government's control over the issue of capital, pricing of issues, fixing of premia and rates of interest on debentures, and allowed the market to allocate resources to competing uses. In place of the government control of these aspects of the market, SEBI issued so-called Disclosure and Investor Protection (DIP) guidelines in 2000 for the benefit of investors. The DIP guidelines allowed issuers to offer securities at a predetermined price or investors to determine the price through book building. The guidelines contained 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 whole truth and nothing else. The guidelines are aimed to secure full disclosure of relevant information about the issuer and the nature of the securities to be issued, so that investors can make informed decisions. For example, issuers were required to disclose any material *risk factors* and give justification for pricing

in their prospectus. The DIP guidelines cast a responsibility on the lead managers to issue a due diligence certificate, stating that they have examined the prospectus, they find it in order and that it brings out all the facts, and does not contain anything wrong or misleading. After a few amendments, the DIP guidelines have recently (in August 2009) been replaced by the Issue of Capital and Disclosure Requirements (ICDR) regulations, which currently govern the issue-related disclosures in India.

The ICDR regulations establish norms relating to eligibility for companies issuing securities, pricing of issues, listing and disclosure requirements, lock-in period for promoters' contribution, contents of offer documents, pre- and post-issue obligations, and other areas some of which are discussed in the following paragraphs^{1,2}. Some of the major features of the ICDR regulations are listed in Appendix 2A.I.

PRIMARY MARKET OUTCOME

Average annual capital mobilization by non-government public companies from the primary market, which used to be about Rs 0.7 billion in the 1960s and about Rs 0.9 billion in the 1970s, increased manifold during the 1980s, reaching Rs 43.12 billion in 1990–91. It received a further boost during the 1990s with the capital raised by these companies rising sharply to Rs 264.17 billion in 1994–95 (see Appendix 2A.II).

The market dried up for about a decade from 1995–96, due to the interplay of demand and supply side forces. Many investors who were lured into the market during 1992–94, adopted a very cautious approach because of their frustration with some of the issuers and intermediaries associated with the securities market. They withdrew from the market for a while, and looked for quality issues, the availability of which declined due to stricter eligibility criteria for public issues imposed by SEBI, and because of the

¹ The SEBI Act, 1992, conferred the powers of delegated legislation on SEBI to frame regulations to deal with matters relating to issue of capital, transfer of securities, and the like. These matters are currently governed by the DIP Guidelines, however, and not by regulations. In order to improve enforceability, SEBI is in the process of converting the guidelines into regulations, as envisaged in the Act.

² The detailed ICDR regulations (with amendments) are available at: <http://www.sebi.gov.in/acts/Capitaldisclosure.html>.

general slowdown in economic activity. Private capital mobilized in the primary market declined to a low of Rs 18.78 billion in 2002–03.

Simultaneously, issuers shifted attention to alternate avenues for raising resources like private placement, where compliance is much less onerous; and to the overseas market, which is cost effective. Available data, although scanty, indicate that private placement has become a preferred means of raising resources by the corporate sector. It is believed in some circles that private placement has crowded out public issues. There are several inherent advantages of relying on the private placement route for raising resources. While it is a 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 a public or rights issues.

The authorities took swift action to revive sentiment in the primary market. They enhanced the eligibility criteria for the entry of issuers into the market to ensure better quality issues. They also took stringent steps against unscrupulous issuers who had raised funds from the public through IPOs in the 1990s and subsequently failed to comply with the listing/filing requirements of the Registrar of Companies and the Stock Exchanges, and who could not be located at their registered office address. One hundred and twenty two such companies, that made IPOs during 1992–2001, have been identified. SEBI has issued orders against these companies and their directors/promoters, prohibiting them from associating in any way with capital market activities and accessing the capital market for a period of five years. The Ministry of Corporate Affairs has filed prosecutions against these companies and their promoters/directors for misstatement in prospectus, fraudulently inducing persons to invest money, false statement made in the offer documents, and for non-filing of statutory returns.

The availability of good public issues (particularly PSU disinvestments), with the improved perception about regulatory effectiveness (the Indian Household Investor's Survey 2004 by SCMRD has found that there has been great improvement recently in the general public perception about capital market regulation in India), attracted the attention of retail investors to public issues. This was further reinforced by the high rate of return given by the public issues and the growth story of the Indian economy. The year 2003–04 witnessed a revival in resource mobilization by non-government public companies with the amount increasing to Rs 316 billion in 2006–07 and to Rs 636.38 billion in 2007–08.

The amount raised by the corporate sector through public and private issues (Appendix 2A.II) is quite impressive. However, most of the amount is raised through the private placement of debt securities. It is believed that

debt accounts for a large part of the amount rose through private placement. The amount raised through private placement equity issues though is not insignificant. A total of 177 NSE-listed companies privately placed equities mobilizing a total of Rs 242 billion during 2007–08.

With the experience of the early 1990s, which witnessed many fly-by-night operators, investors preferred debt instruments. From zero percent in 1994–95, the share of debt in public issues rose to 25 percent in 1995–96 and peaked at 94 percent in 1998–99 (see Table 2.4). From 2003–04 onwards the share of debt started declining and reached zero percent again in 2005–06.

Table 2.4: Debt and Equity Shares of Public Issues,
1994–95 to 2007–08

Year	Share (%) in public issues	
	Debt	Equity
1994–95	0	100
1995–96	25	75
1996–97	60	40
1997–98	63	37
1998–99	94	6
1999–00	61	39
2000–01	63	37
2001–02	83	17
2002–03	82	18
2003–04	20	80
2004–05	16	84
2005–06	0	100
2006–07	0	100
2007–08	2	98

Source: Prime Database.

Thus today in India corporations mainly use private placements to raise debt capital, and public issues are largely used for equity capital. It may be noted that debt capital is temporary and has to be repaid on maturity. Hence, most of the capital being raised by the corporate sector is not going to be available to them permanently. What would, therefore, be relevant is the net amount raised through debt securities; that is, the amount raised minus the amount repaid during the year. If such data were available, the amount raised would not look as impressive. Since such data are not available, the amount raised from the securities market appears impressive.

Despite massive modernization of the market over the years and introduction of best market practices, the government or public sector

continues to dominate India's securities market. Out of the Rs 5.78 trillion raised during 2007–08, Rs 2.6 trillion was raised by the government. Besides this, the public sector accounted for 24 percent of the funds raised through public issues and 39 percent of funds raised through private placement during 2007–08. The government/public sector not only raised huge resources from the securities markets, they also invested heavily through the securities market as subscribers to government securities and private placements.

Public issues are eliciting very good response in the market. Despite book building, which allows price determination within a price band, over half of the public issues each year from 2003–04 to 2007–08 have been more than three times oversubscribed (see Table 2.5). There are instances of an issue getting oversubscribed four hundred times. Given this kind of response, probably the issues would have been priced much higher, if there were no price bands.

Table 2.5: Response to Public Issues (% of Public Issues)

Times subscribed	2007–08	2006–07	2005–06	2004–05	2003–04
Refunded/Devolved	7	11	0	0	3
≤ 1.5 Times	15	15	2	18	17
1.5–3 Times	11	16	12	6	14
3–10 Times	23	25	28	21	35
≥ 10 Times	44	33	58	57	31
Total	100	100	100	100	100

Source: Prime Database.

Not only were issues oversubscribed, they also fetched huge premium. In 2007–08, for example, 94 percent of the total amount raised was by way of premium while the nominal value of equity was only four percent of the total (see Table 2.6).

Table 2.6: Composition of Capital Raised through Public Issues

Year	Share (%) in capital raised through public issues		
	Premium	Equity	Debt
2002–03	11	7	82
2003–04	75	6	19
2004–05	78	6	16
2005–06	92	8	0
2006–07	92	8	0
2007–08	94	4	2

Source: Prime Database.

Maharashtra continued at the top position with 65 percent share of country's total response (excluding qualified institutional buyer [QIB] portion of book building issues) in the public issues made in 2007–08. Mumbai, the capital city of Maharashtra, contributed 64 percent of the total subscriptions (excluding QIB portion of book building issues) received for public issues during the year. Maharashtra and Mumbai contributed 98.56 percent of the subscriptions received under the QIB portion of book building issues. The state-wise response to public issues (excluding QIB portion of book building issues) is presented (see Table 2.7).

**Table 2.7: State-wise Response to Public Issues
(% of Total Funds Raised)**

(excluding QIB issues)

State	2005–06	2006–07	2007–08
Maharashtra	64.58	68.55	64.71
Gujarat	16.56	13.64	12.58
Delhi	5.64	6.39	10.51
Rajasthan	1.54	2.05	2.76
West Bengal	2.84	2.00	2.32
Tamil Nadu	2.29	1.70	1.49
Karnataka	1.79	1.61	1.48
Andhra Pradesh	1.86	1.27	1.12
Rest of India	2.9	4.79	3.24
Total	100.00	100.00	100.00

Source: Prime Database.

SECONDARY MARKET DESIGN

The secondary market enables participants who hold securities to adjust their holdings, in response to changes in their assessment of risk and return, and to sell securities for cash to meet their liquidity needs. The secondary market has two components, namely the over-the-counter (OTC) market and the exchange-traded market. OTC markets are different from the market place provided by the over-the-counter Exchange of India Limited (OTCEI). OTC markets are essentially informal markets where trade is 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 the spot market is the cash market,

where settlement takes place after sometime. Trades taking place over a trading cycle, that is, a day under rolling settlement, are settled together after a certain time (currently two working days). All stock exchanges in the country provide facilities for trading of equities. Trades executed on the leading exchange, like NSE, are cleared and settled by a clearing corporation which provides novation and settlement guarantee. The trades on other exchanges are cleared and settled through clearing houses. The trades on all exchanges enjoy settlement guarantee. Over 99.99 percent of the trades settled by delivery are settled in demat form.

Stock Exchanges

The stock exchanges, recognized under the SCRA, are the exclusive centers for trading of securities. Though the area of operation for each exchange was specified at the time of its initial recognition, recently the exchanges have been allowed to set up trading terminals anywhere in the country and three newly established exchanges (OTCEI, NSE, and ICSE) were permitted since their inception to have nationwide trading. The trading platforms of a few exchanges are now accessible from many locations and the trading platforms of some are also accessible from anywhere through Internet and mobile communications devices. Until recently the brokers of an exchange were restricted to trading among themselves, but 2004 amendment to the SCRA allowed them to trade with the brokers of other stock exchanges also. Small exchanges have entered into MOUs with larger exchanges, which allow the brokers of small exchanges to use the trading platform of the big exchanges.

Demutualization

At the end of March 2005, only 3 exchanges (Mumbai, Ahmedabad, Madhya Pradesh) were organized in the form of "Association of Persons," while the balance 20 were organized as companies—either limited by guarantee or by shares. Except one exchange (NSE), all exchanges, whether corporates or association of persons, were not-for-profit organizations. Of the 23 exchanges, two (NSE and OTCEI) had adopted a demutual structure since their inception. On realizing the limitations of a mutual and non-corporate structure and discovering the advantages of a demutual and corporate structure, the exchanges (except two exchanges—NSE and OTCEI—who were already demutualized) were mandated by the Securities

Laws (Amendment) Act, 2004 to demutualize and corporatize themselves by an appointed date. SEBI accordingly approved the corporatization and demutualization schemes of 19 Exchanges in 2005.

The salient features of these schemes are:

1. The stock exchanges that were Association of Persons were converted into for-profit companies limited by shares. The exchanges that were companies limited by guarantee were converted/re-registered into companies limited by shares.
2. The ownership and management rights and trading rights associated with membership cards were segregated. It is now not necessary for a shareholder to be a trading member, and vice versa.
3. The membership cardholders became initial shareholders of the emerging Exchange which ensured that public—other than shareholders having trading rights—hold at least 51 percent of its equity shares.
4. No shareholder who is a trading member has voting rights (taken together with voting rights held by him and by persons acting in concert with him) exceeding 5 percent of the voting rights in the emerging Exchange.
5. The membership cardholders, limited trading members, and trading members of the derivative segment became trading members of the respective segments of the emerging Exchanges initially.
6. After Corporatization and Demutualization (C&D), there is only one class of trading members with similar rights and privileges, and uniform standards are followed in terms of capital adequacy, deposits, fees, and so on, while admitting any person as a trading member or accepting his surrender.
7. The Governing Board of the emerging Exchanges is so constituted that the representatives of the trading members do not exceed one-fourth of its total strength and the remaining directors are appointed in the manner specified by SEBI from time to time. The chief executive of the exchange is an ex-officio director on the governing board and SEBI has the right to nominate directors as and when deemed fit. (see Table 2.8 for rules on the composition of the governing boards of the exchanges.) The trading members clear and settle trades until the clearing and settlement functions are transferred to a recognized clearing corporation.
8. The Exchanges ensure that the assets and reserves transferred from the erstwhile exchange are utilized only for the operations of the stock exchange.

Table 2.8: Composition of Governing Board of Exchanges

<i>Stakeholders</i>	<i>Designation</i>	<i>Status</i>	<i>Who may represent</i>	<i>Who may elect/appoint</i>	<i>Extent of representation</i>
Trading Members	Trading Member Director	Non-Executive	Trading Members	Shareholders	≤ 1/4
Investors, Listed Companies, Society, and others.	Public Interest Director	Non-Executive	A person from the SEBI Panel	Shareholders	1/4
Shareholders	Shareholder Director	Non-Executive/ Executive	Any Person who is not a Trading Member or Associate of a Trading Member	Shareholders	Balance
Exchange Administration	Chief Executive	Executive	Professional	Board	One

Source: SEBI.

Two major elements of the demutualization process were conversion to a corporate entity and divestment of 51 percent equity to non-trading members. The exchanges completed conversion in 2006–07. They completed divestment in 2007–08. In all, 521 investors (146 corporates and 375 individuals) subscribed to the equity capital of 16 exchanges. These investors include 43 listed companies and a few foreign entities/exchanges. Various other activities associated with C&D have been completed within the time specified in the respective approved schemes. The exchanges that failed to do so have been derecognized. Currently, there are 19 recognized stock exchanges in India, out of which 16 are fully corporatized and demutualized.

Market Developments

Electronic Communication Networks (that facilitate trading of securities among their subscribers), Crossing Networks (that matches orders for execution without first routing to an exchange), and Negotiated Dealing Systems (which match orders in government securities) are market innovations that challenge the core functions of the exchange. Similarly, there are electronic systems which display buy–sell quotes of counter parties to enable buyers and sellers in the corporate bond market to strike deals either at the exchange or bilaterally. These ATSs, some of which are called *dabba* trading in the Indian context, are diverting trades from exchanges. Specialized securities settlement systems have come up the world over to handle post trading activities. The law in some jurisdictions requires clearing and settlement functions to be discharged by a clearing corporation. National Securities Clearing Corporation Ltd. and Clearing Corporation of India Ltd. provide central counter party guarantee and clear and settle trades in corporate and government securities respectively in India. Organizational innovations have resulted in the exchanges losing part of their self regulatory status. This is both because of the perceived conflict of interest between commercial aspirations and regulatory tasks, as well as the search for new turf by the statutory regulators. Rules of trading, the obligations of listed companies, service standards of brokers, and others, which used to be traditionally handled by exchanges, have been substantially taken over by regulators.

Market innovations (alternate trading systems—ATS), institutional innovations (emergence of regulators and SROs, clearing corporations), and organizational innovations (corporatization and demutualization) have been making the horizon too narrow prompting questions on their very relevance. Trading, clearing, settlement, market regulation, listing, and broking are no more the exclusive prerogative of exchanges. While core functions of

an exchange are being taken over by/transferred to other agencies, the definition of Stock Exchange in the SCRA in India hardly protects the turf of the exchange. The elements of a stock exchange under the law are: (a) it is a body corporate, (b) incorporated under the Companies Act, (c) for the purpose of assisting, regulating, or controlling, (d) business of buying, selling or dealing in (e) securities. Thus, all corporate intermediaries in securities market, all of whom assist in dealing in securities, are stock exchanges, while the Negotiated Dealing System which provides a trading platform for government securities is not, as it is not a body corporate.

Trading Membership

The trading platform of an exchange is accessible only to trading members. They execute trades, either on their own account, or on behalf of their clients. With demutualization, trading membership is available on tap—there is free entry and free exit. The standards for admission of members stress factors, such as corporate structure, capital adequacy, track record, education, experience, and so on, and reflect a conscious endeavor to ensure quality broking services. No stockbroker or sub-broker is allowed to buy, sell, or deal in securities, without a certificate of registration, granted by SEBI. A broker/sub-broker must comply with SEBI's code of conduct. Since the mid-nineties, a number of brokers—traditionally proprietor firms and partnership firms—have converted into corporate form. Out of 9,487 brokers (cash segment) registered with SEBI at the end of March 2008, 4,190 brokers (44 percent of the total), were corporate entities. This is in sharp contrast to 1994 when only 2 percent of the 6,413 brokers were corporate entities.

At end-March 2008, there were 44,073 sub-brokers registered with SEBI. Of these, 16,533 were registered during 2007–08 alone. Two major exchanges, namely NSE and BSE, account for 97 percent of sub-brokers. The small exchanges have floated subsidiaries, which have taken trading membership on bigger exchanges and about 1,299 brokers of small exchanges trade as sub-brokers through these subsidiaries. They accounted for about 0.86 percent of the cash market turnover on exchanges during 2007–08.

Until 1985 the law allowed only individuals to become brokers; stock broking was viewed as a profession requiring individual skills and individual attributes. Eventually, this thinking changed and the need for better broking services was felt. By a notification in June 1986, government removed the prohibition on companies becoming brokers, initially permitting section 322

companies to become brokers of the stock exchanges. Then, in November 1988, the prohibition on becoming a broker on more than one exchange was withdrawn.

Despite these initiatives, corporate brokership did not take-off. Legal changes effected in November 1992 opened the brokership of stock exchanges to limited liability companies. The Income Tax Act, 1961, was amended in 1997, to exempt corporatization of broking entities from capital gains tax, in order to encourage existing brokers to corporatize, which was considered desirable for the development of the securities market. The SEBI Regulations, 1992, were amended in January 1998 to provide for fee continuity benefit on conversion. In response, many brokerage firms reorganized into corporate entities. Thus, a conscious effort has been made to convert broking from a professional activity to a business activity, and the brokerage entity from proprietorship form to corporate form. This trend would continue, now that the regulators, exchanges, brokers, and investors have recognized the improved quality of service and compliance that come with corporatization, and we can expect that individuals may soon be prohibited from becoming brokers.

Corporatization enabled brokers to invest heavily in technology. As technology to automate securities transactions became affordable, the exchanges provided electronic trading platforms. Brokers embraced this technology, not only because it was necessary to access the electronic trading system, but also because it improved efficiency, provided huge economies of scale, and made compliance much easier. This allowed them to undertake additional business at negligible or zero marginal cost. Inputting an additional 1,000 orders on the National Exchange for Automated Trading (NEAT) trading system today, for example, does not add to a broker's cost. On the other hand, small brokers found the cost of setting up systems and complying with ever-increasing rules and regulations of the SEBI and Exchanges too heavy for them to break even. This is because of the nature of the business of broking and the technology which provide substantial economies of scale, after a threshold level of investments. This trend will continue; big brokers will continue to invest in technology and human resources and grow bigger, while small brokers will fail to do so, and consequently, fail to provide quality services to clients, to meet the ever-increasing compliance requirements, and gradually withdraw from the market. A few brokers, with financial muscle and the available technology, can cater to the needs of the whole market. A bank with 13,000 branches can offer trading terminals in all its branches, and if a few banks do so, clearly there is no space for 10,000 brokers in the market.

Listing

The basic norms for listing of securities on the stock exchanges are uniform for all the exchanges. These norms are specified in the listing agreements entered into by the company and the 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. In case a company fails to comply with the requirements, trading of its security is suspended for a specified period, or it is delisted, in addition to the penalty as prescribed in the SCRA.

A listed security is available for trading on the exchange. A security listed on other exchanges is also permitted for trading. At the end of March 2004, a total of 9,359 companies were listed on Indian exchanges. These are the latest figures available for the total number of listed companies in India. This has not been tracked for small exchanges which have no trading. With the withdrawal of the requirement for listing on regional exchanges and the liberalization of delisting, no new company is seeking listing on small exchanges, and the existing listed companies are being gradually delisted. Similarly, total market capitalization of securities listed on Indian exchanges is also not tracked. At the end of March 2008, however, the BSE listed 4,887 companies (7,681 securities) and permitted 63 for trading, while the NSE listed 1,381 companies.

Dissemination of Corporate Information

SEBI set up an Electronic Data Information Filing and Retrieval (EDIFAR) System in June 2002 to facilitate electronic filing of certain information disclosed by listed companies under the listing agreement. This is an automated system for filing, retrieval, and dissemination of time-sensitive corporate information, which is filed physically by the listed companies with the stock exchanges. The system enables online filing of information relating to: (a) financial statements comprising of balance sheets, profit and loss account, full version of annual report, half yearly financial statements including cash flow statements, and quarterly financial statements; (b) corporate governance reports; (c) shareholding pattern statement; (d) statement of action taken against the company by any regulatory agencies; and (e) such other statement,

information, or report as may be specified by SEBI from time to time in this regard. The primary objective is to centralize the information and accelerate its dissemination, and thereby enhance transparency and efficiency for the benefit of various classes of market participants. This is analogous to the Electronic Data Gathering, Analysis and Retrieval (EDGAR) system of the US Securities Exchange Commission.

In order to enhance transparency further, SEBI is phasing out EDIFAR and is working to replace it by another more versatile platform called www.corpfiling.co.in, which is jointly hosted by the NSE and the BSE. This aims at providing a single window filing to listed companies, irrespective of multiple listing and a one-stop shop for sourcing corporate information of listed companies by investors. It was launched on January 1, 2007. Initially 100 companies, selected on the basis of market capitalization, were mandated to file their information through the new platform.

Corporate Governance

The listing agreement prescribes corporate governance norms for listed companies. It requires a listed company (with a paid-up share capital of Rs 30 million and above or net worth of Rs 250 million or more at any time in history) to comply with the norms relating to composition of the board and audit committee, compensation to directors, various disclosures such as related party transactions, risk management, and so on. It, inter-alia, requires that:

1. Not less than 50 percent of the board shall be non-executive directors.
2. Where the Chairman of the Board is a non-executive director, at least one-third should comprise independent directors, and in case he is an executive director, at least half should comprise independent directors.
3. The compensation/fees to non-executive directors, including independent directors, shall be approved by the general body.
4. The Board shall lay down a code of conduct for its members and senior management of the company. All board members and senior management personnel shall affirm compliance with the code on an annual basis.
5. A qualified and independent audit committee shall be set up with minimum three directors as members. Two-thirds of the members

of audit committee shall be independent directors. This committee will exercise oversight of the financial reporting process and the disclosures of financial information.

6. At least one independent director of the company shall be a director on the board of a material non-listed Indian subsidiary company.
7. All related party transactions must be considered by the Company's audit committee periodically and should also be disclosed in the Annual Report.
8. The annual report shall have a separate section providing details on compliance with corporate governance norms.

The stock exchanges have set up a separate cell to monitor compliance with corporate governance provisions. This cell obtains the quarterly compliance reports from companies and submits a consolidated compliance report to SEBI within 60 days of the end of the quarter. Further, the Exchanges issue show-cause notices to companies that have not submitted the Corporate Governance Report on a quarterly basis, and in case of non-submission, this is followed by suspension of trading in the securities of the company. SEBI also initiates action against non-complying companies under the SCRA.

Delisting

The earliest trace of provisions relating to delisting is found in a government circular issued on June 28, 1979, which permitted stock exchanges to delist securities if they had incurred losses during the preceding three years, remained infrequently traded, and if they still would remain listed on at least one exchange. If a company did not fulfill any of the conditions, an approval of the government was required. In 1985, the exchanges were allowed to delist if the number of shareholders fell below five or if Rs 10,000 of capital and public shareholding fell below 50 percent of the public offer. SEBI issued a detailed circular on April 29, 1998, to provide for voluntary and compulsory delisting. It issued the SEBI (Delisting of Securities) Guidelines in 2003, under section 11 of the SEBI Act. It allows a listed company to voluntarily delist its securities from a stock exchange after providing an exit opportunity to holders of securities at a price determined through reverse book building. An exit opportunity is not necessary if the security remains listed on an exchange having nationwide trading terminals.

Without a statutory provision, it was questionable whether delisting was legally permissible at all. This situation was clarified by an amendment to the SCRA 2005, which explicitly provided for delisting of securities. It provides that an exchange may delist securities after recording reasons thereof on any of the grounds, as may be prescribed after giving the company concerned an opportunity of hearing.

The rules are being amended to provide the grounds for delisting. It has been proposed that an exchange may delist any security on any of the following grounds:

1. The company has incurred losses during the preceding three consecutive years and it has negative net worth.
2. Trading in the securities of the company has remained suspended for a period of more than six months.
3. The securities of the company have remained infrequently traded during the preceding three years.
4. The company or any of its promoters or directors have been convicted for failure to comply with the securities laws and awarded a penalty of not less than rupees one crore or imprisonment of not less than three years.
5. The addresses of the company or any of its promoters or any of its directors are not known or false addresses have been furnished or the company has changed its registered office in contravention of the Companies Act, 1956.
6. Shareholding of the company held by the public has come below the minimum level applicable to the company as per the listing agreement under the Act and the company has failed to raise public holding to the required level within the time specified by the recognized stock exchange.

If a security is delisted, the promoters and directors of the company shall be jointly and severally liable to purchase the outstanding securities from those holders who wish to sell them at a fair price determined in accordance with regulations made under the Act by SEBI.

An exchange may, on a request by a company, delist any securities, subject to the conditions: (a) the securities of the company have been listed for a minimum period of three years; (b) the delisting of such securities have been approved by shareholders by special resolution through postal ballot and the company. Promoters and/or the directors of the company purchase the outstanding securities from those holders who wish to sell them at a price determined in accordance with regulations made under the Act by SEBI.

This obligation may be dispensed with by SEBI, if the securities remain listed at least on the NSE or the BSE.

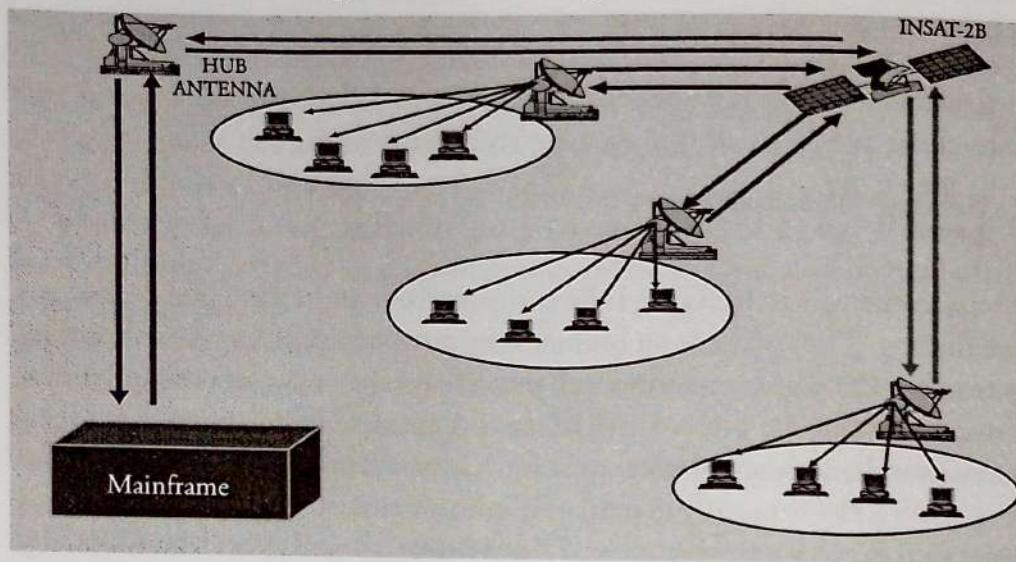
Trading Mechanism

All the exchanges in India are fully computerized and offer 100 percent on-line trading. They provide an online, fully automated, screen-based trading system (SBTS) where a member can punch into the computer the quantities of securities and the prices at which he/she would like 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, thereby 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 a real-time basis, 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. The trading platform is also accessible to an investor through the Internet and mobile devices such as WAP (Wireless Application Protocol). It also provides a perfect audit trail, which helps to resolve disputes by logging in the trade execution process in its entirety. A typical trading network is presented in Figure 2.1.

At the end of March 2008, NSE permitted 305 members on the cash market segment to allow clients web-based access to its trading system. These members, in turn, have registered 4.5 million clients for web-based access. About 301 million trades for Rs 6,680 billion constituting 18.82 percent of the total trading volume were routed and executed through the internet during 2007–08.

SEBI allowed direct market access (DMA) facility in April 2008. This facility allows a broker to offer clients direct access to the trading system of an exchange through its infrastructure without manual intervention. This enables better exploitation of hedging and arbitrage opportunities through the use of improved decision support tools and/or algorithms for trading. However, brokers are not allowed to cross trades of their clients with each other.

Figure 2.1: Trading Network



Source: NSE.

SEBI has framed regulations to prohibit insider trading, as well as unfair trade practices. The acquisitions and takeovers are permitted in a well-defined and orderly manner. Thresholds of shareholding, which require disclosure or public offer, have been prescribed. The companies are permitted to buy back their securities to improve liquidity and enhance the shareholders' wealth.

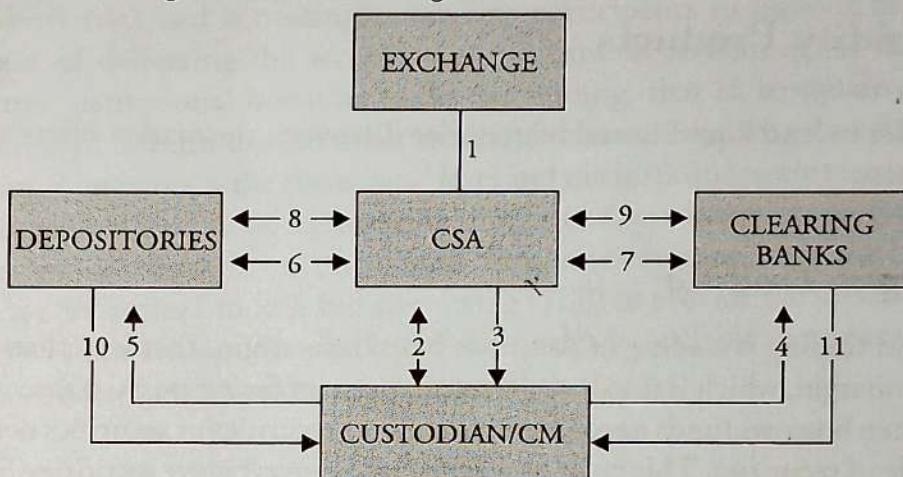
Settlement

Trades accumulate over a trading cycle of one day, and at the end of the day they are clubbed together—positions are netted, payment of cash, and delivery of securities settle the balance after two working days. All trades executed on day T are settled on day $T+2$.

Trades are executed on-screen and matched trade details are linked to settlement systems electronically, and hence matching and confirmation of trades for direct participants are instantaneous. All communications relating to securities settlement are fully electronic and automated. For instance, the clearing agency downloads the obligations and pay-in advices of funds/securities to members electronically through secured networks. It also sends electronic advice to clearing banks and depositories to debit the members' accounts to the extent of their obligations. The banks and

the depositories debit accounts of members and credit the account of the clearing agency electronically. The reverse happens when the funds/securities are paid out to members. The exchange is connected electronically to the clearing and settlement agency, which in turn is connected electronically to clearing banks, depositories, custodians, and members. The depositories have electronic communication with depository participants, clearing agency, custodians, clients, and exchanges. Most of these electronic communications are interactive. The typical clearing and settlement process is presented in Figure 2.2.

Figure 2.2: Clearing and Settlement Process



Notes:

1. Trade details from Exchange to Clearing and Settlement Agency (CSA) (real-time and end-of-day trade file).
2. CSA notifies the consummated trade details to CMs/custodians who affirm back. Based on the affirmation, CSA applies multilateral netting and determines obligations.
3. Download of obligation and pay-in advice of funds/securities.
4. Instructions to clearing banks to make funds available by pay-in-time.
5. Instructions to depositories to make securities available by pay-in-time.
6. Pay-in of securities (CSA advises depository to debit pool account of custodians/CMs and credit its account and depository does it).
7. Pay-in of funds (CSA advises Clearing Banks to debit account of custodians/CMs and credit its account and clearing bank does it.) CSA transfers funds between clearing banks to meet the pay-out requirements at each bank.
8. Pay-out of securities (CSA advises depository to credit pool account of custodians/CMs and debit its account and depository does it).
9. Pay-out of funds (CSA advises Clearing Banks to credit account of custodians/CMs and debit its account and clearing bank does it).
10. Depository informs custodians/Clearing Members (CMs) through DPs.
11. Clearing Banks inform custodians/CMs.

Except at the stage of entering orders into trading system, no data is entered manually or electronically in the entire value chain. No fresh input of data takes place at any stage. Data flows seamlessly among the entities, namely, from exchanges to clearing agency and from clearing agency to clearing banks, depository, members, and custodians. Once a trade is executed, it has to be settled. There is no way to cancel it. The clearing corporations or houses have been allowed to borrow and settle the trades on behalf of the brokers who fail to deliver securities. The largest exchange already uses the services of a clearing corporation to clear and settle the trades.

Liquidity Products

In order to lend liquidity and better price discovery, the market offers a few products.

Margin Trading

Margin trading is trading in securities based on margin, that is, a client deposits margin, which is usually a percent in value of the proposed transaction, and then borrows funds needed for purchase of securities or securities needed for sale of securities. This enables a client to sell/invest more securities/funds than what he would otherwise have been able to with his own resources. This increases the supply of and demand for securities/funds in the market. It thus contributes to liquidity by making higher trading volumes possible, than it would have been otherwise. Margin trading and trading of derivatives generally complement rolling settlement, where the time for roundabout transactions is limited to a day.

In March 2004, SEBI allowed brokers to provide margin trading facility to their clients in the cash segment. The facility is available in respect of securities having mean impact cost of less than or equal to one and having traded on at least 80 percent (+/- 5 percent) of the days for the previous eighteen months. Only corporate brokers with a net worth of at least Rs 30 million are eligible to offer margin trading facility to their clients. For the purpose of providing the margin trading facility, a broker may use his own funds or funds borrowed from scheduled commercial banks and/or non-bank financial companies (NBFCs) and not funds from any other source. At any point of time, the total indebtedness of a broker for the purpose of margin trading shall not exceed five times of his net worth. The initial and

maintenance margin for the client shall be a minimum of 50 percent and 40 percent respectively, to be paid in cash.

Short Sales

Short selling allows a person to sell a stock he does not own. It increases liquidity in the market and makes price discovery more efficient. Besides, it curbs manipulation of stocks as informed investors are able to go short on stocks they feel are higher than the fair value. This facility was available to non-institutional investors. Vide a circular in February 2008 SEBI has permitted all classes of investors to short sell. It, however, does not permit naked short sales and accordingly, requires participants to honour their obligation of delivering the securities at the time of settlement. It does not permit institutional investors to do day trading, that is, to square-off their transactions intra-day. In other words, all transactions are grossed for institutional investors at the custodians' level and the institutions are required to fulfill their obligations on a gross basis. The custodians, however, continue to settle their deliveries on a net basis with the stock exchanges. It has put in a scheme for Securities Lending and Borrowing (SLB) to provide the necessary impetus to short selling. The facility of short sales is available in respect of securities traded in the derivatives segment of exchanges.

Securities Lending and Borrowing

The facility of securities, lending, and borrowing makes the settlement process in the cash market more efficient by doing away with auctions or settlement by cash. In case of a settlement shortage, the facility enables a participant to borrow stocks to ensure full delivery. As a result, the buyer gets securities instead of cash. Besides, it facilitates physical settlement in the derivatives segment and thereby enhances arbitrage activity between the derivatives and cash markets, leading to better price discovery.

Until early 1997, the market did not have this facility, precisely because it did not have acute need for the same. It was because of an indigenous product called *badla*—product blending features of stock futures and stock lending—in the market that blended the features of stock futures and stock lending. The market also had account period settlement which was, in fact, $T + n$. However, in order to upgrade the settlement system and to adopt best international practices, SEBI notified the Securities Lending Scheme 1997 (SLS, 97) in February 1997. The tax laws were modified to support securities lending. The scheme enabled a person to lend securities to another person

through an approved intermediary, with the condition that the borrower shall return equivalent securities within the specified time, along with all corporate benefits that may have accrued during the period of borrowing. A few approved intermediaries got registered and offered OTC stock lending, which was not widely used by the market. An exchange-administered securities lending scheme was introduced sometime in 2000 and settlement of such lending was clubbed with normal settlement. This scheme created market volumes, but it became prey to a major market misdemeanor in early 2001. Following this, all deferral products like *badla*, exchange-administered stock lending products, and OTC stock lending were banned. Later on, only OTC stock lending was allowed. The entire market shifted to rolling settlement, and the full range of derivatives was introduced. The stock lending scheme was reviewed and a revised scheme was notified only on March 19, 2004. However, it did not take-off.

In February 2008, SEBI issued a modified securities lending and borrowing (SLB) scheme. The salient features of the scheme are:

1. To begin with, the SLB scheme would be operated through the clearing corporations or clearing houses of stock exchanges having nationwide terminals that will be registered as Approved Intermediaries (AIs) under the SLS, 1997.
2. The SLB would take place on an automated, screen-based, order-matching platform which will be provided by the AIs. This platform would be independent of the other trading platforms.
3. To begin with, the securities traded in the derivatives segment would be eligible for lending and borrowing under the scheme.
4. All categories of investors including retail and institutional, will be permitted to borrow and lend securities. The borrowers and lenders would access the platform for lending/borrowing set up by the AIs through the clearing members (CMs) who are authorized by the AIs in this regard.
5. The tenure of lending/borrowing would be fixed as standardized contracts. To start with, contracts with tenure of seven trading days may be introduced.
6. The settlement cycle for SLB transactions would be on a T+1 basis. The settlement of lending and borrowing transactions would be independent of normal market settlement.
7. The settlement of the lending and borrowing transactions should be done on a gross basis at the level of the clients, that is, no netting of transactions at any level will be permitted.

Risk Management

To pre-empt market failures and protect investors, the regulator and Indian 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, indemnity insurance, on-line position monitoring, and automatic disablement. They also administer an efficient market surveillance system to curb excessive volatility and to detect and prevent price manipulations. Exchanges have set up trade/settlement guarantee funds for meeting shortages arising out of non-fulfillment or partial fulfillment of fund obligations by the members in a settlement. A clearing corporation assumes the counterparty risk of each member and guarantees financial settlement of trades executed on the Exchanges.

The risk management system currently followed by the exchanges, in cash and derivative market, comprises of VaR-based margin, mark-to-market margin, and additional client concentration margins. It updates risk parameters six times during the day to ensure that the risk computation is up-to-date. Based on these systems, risk management is conducted on an online, real-time basis at the client level. There is real time, automatic disablement of broker terminals once margins are exhausted and the broker fails to replenish margins in time. The exchanges provide counter-party guarantee through a separate clearing corporation or through a settlement guarantee fund. They are required by SEBI to monitor the fund, its investments, and also to continuously review the size of the fund through stress testing.

Stock market volatility is generally a cause of concern for policy makers, as well as investors. To curb excessive volatility, SEBI has prescribed a market-wide circuit breaker system. A 10 percent, 15 percent or 20 percent (depending on the time of day) movement, either way, in the S&P CNX Nifty, or the Sensex indices, that triggers a coordinated trading halt in all equity and equity derivatives markets nationwide (see Table 2.9). (Nifty is a diversified index of 50 large company stocks on the NSE representing 22 sectors of the economy). As an additional measure of safety, exchanges have imposed individual scrip-wise price bands (circuit filter) as high as 20 percent in some securities. However, on securities for which derivative products are available or those included in indices on which derivative products are available, a daily price limit of 10 percent is applicable.

SEBI has put in place a regular system of weekly surveillance meetings with stock exchanges and depositories to provide a confidential platform for

Table 2.9: Operation of Circuit Breakers

% Change in Index	Before 1 pm	Between 1-2.30 pm	After 2.30 pm
10	1 hr halt	½ hr halt	No halt
15	2 hr halt	1 hr halt	Halt for remainder of the day
20	Complete halt for the remainder of the day		

Source: SEBI.

exchange of views on areas of emerging concern or specific abnormalities, and to consider pre-emptive action and discuss surveillance issues.

Margining

Transactions executed by institutions such as Foreign Institutional Investors, Domestic Institutional Investors, Mutual Funds, Banks, and Insurance companies were earlier exempt from margin requirements. In order to provide a level playing field, particularly after institutions were allowed to short sell, SEBI has mandated margining of institutional transactions, with effect from April 21, 2008. The institutional transactions are margined only from day T+1, subsequent to confirmation by the custodians.

Many trading members undertake transactions on both the cash and derivative segments of an exchange, and keep separate deposits with the exchange for taking positions in the two different segments. As a result, at times it happens that while a member has excess deposit in one segment, he is not able to take further positions in the other segment as the deposit there has already been used up. In order to improve the efficiency of the use of this deposit capital by trading members, SEBI has allowed cross margining in May 2008. To start with, it has allowed the following:

1. Cross margining is available for institutional trades.
2. Cross margining is available to positions in cash market having corresponding off-setting positions in the stock futures market.
3. For positions in the cash market which have corresponding offsetting positions in the stock futures, VaR margin is not levied on the cash market position to the extent of the off-setting stock futures market position.

Charges/Fees and Taxes

Investors are directly or indirectly subjected to various fees and charges on securities transactions that are levied by exchanges, depositories, the SEBI, state governments, and the central government.

The securities transaction tax (STT), which is payable by brokers on transactions, is entered into on recognized stock exchanges. The rates are indicated in Table 2.10.

Table 2.10: Securities Transaction Tax

Type of transaction	Rate (%)	Payable by	Remarks
Delivery-based transactions in equity shares or unit of an equity oriented fund	0.125	Buyer and Seller each	No long-term capital gains tax. 15% short term capital gains payable.
Non-delivery-based transactions in equity shares or unit of an equity oriented fund	0.025	Seller	
Derivatives:			
Sale of an option in securities	0.017	Seller	
Sale of an option in securities, where option is exercised	0.125	Purchaser	
Sale of a futures in securities	0.017	Seller	

Source: SEBI.

In addition, brokers are required to pay a service tax of 12.36 percent on their brokerage income.

A stock exchange is required to pay a regulatory fee to SEBI, based on its annual turnover. An exchange having a turnover of Rs 10 trillion, pays a fee of Rs 20 million.

Stamp Duties

They are payable as per the rates prescribed by the state in which a transaction takes place. In Maharashtra the stamp duty is Re. 1 for every Rs 10,000 or part thereof (that is, 0.01 percent) of the value of an equity security at the time of its purchase or sale. It is charged at 20 paise for every Rs 10,000 or part thereof of the value of transactions in derivatives of securities. The transfer of securities held in demat mode is exempted from stamp duty.

A stock broker in the cash segment is required to pay SEBI a *registration fee* based on its turnover. In the cash segment the fee is 0.00005 percent of turnover in debt securities and 0.0002 percent of turnover in other securities. The fee in the derivative segment is 0.0002 percent of the broker's turnover. A clearing member on the derivative segment pays a fee of Rs 50,000 per year.

The exchanges collect *transaction charges* from their trading members. NSE levies a transaction charge of Rs 3.5 per Rs 0.1 million of turnover in the cash segment and Rs 2 per Rs 0.1 million of turnover in the derivative segment, subject to a minimum of Rs 0.1 million per year. No separate charge is levied for trading or for clearing and settlement.

The maximum brokerage fee a trading member can levy on securities transactions is 2.5 percent of the contract price, exclusive of statutory levies like the SEBI fee, service tax, and stamp duty. This maximum brokerage fee is inclusive of the brokerage fee charged by the sub-broker which shall not exceed 1.5 percent of the contract price. However, brokerage fees as low as 0.15 percent are also observed in the market.

The stock exchanges levy *listing fees*—both initial and annual—on companies whose securities are listed with them. While the initial fee is a fixed amount, the annual fee varies depending upon the size of the company. NSE's initial listing fee is Rs 7,500, and the annual fee is related to paid-up share and/or debenture capital of the securities issued.

A depository is required to pay a registration fee of Rs 25,00,000 and an annual fee of Rs 10,00,000 to SEBI, while a depository participant (DP) is required to pay a registration fee of Rs 1,00,000 and an annual fee of Rs 1,000. The depositories provide depository services to investors through depository participants. They do not charge the investors directly, but charge their DPs who are free to have their own fee structure for their clients. Through a SEBI directive, the account opening charges, custody charges, and the charges on credit of securities have been waived. The depositories may, however, levy charges towards custody from the issuers on a per folio basis. They do not charge anything for dematerialization. They charge Rs 10 for every hundred securities or Rs 10 per certificate, whichever is higher, for rematerialization and Rs 6 for carrying out debit instruction.

Over time competition has been driving down trading costs. The economies of scale and technology have contributed to a further reduction in costs. Although reliable estimates of trading costs over a long period are not available, S&P estimates that from 2000 to 2006 trading costs in India decreased from 113.58 basis points (51.91bp commission + 0.10bp fees + 61.57bp market impact) to 52.72 basis points (31.28bp commission + 9.56bp fees + 11.88bp market impact).

SECONDARY MARKET OUTCOME

The number of stock exchanges, which increased from 11 in 1990 to 23 by 2000, declined to 19 at the end of May 2008, following refusal to renew recognition for exchanges that failed to corporatize and demutualize, as required by the Securities Laws (Amendment) Act of 2004.

Despite India's relatively large number of exchanges, almost the entire activity in the secondary market takes place at NSE or BSE. Between 1990–91 and 1990–2000, the market capitalization of all exchanges in the country grew tenfold (see Table 2.11). It declined thereafter following major market misconduct³ but picked up in 2003–04 to Rs 13 trillion at the end of March 2004.⁴ It reached a peak of about Rs 75 trillion on January 7, 2008 before closing at Rs 51 trillion at the end of March 2008. The market capitalization ratio, which indicates the size of the market relative to the economy as a whole, increased sharply to 109.09 percent of GDP by March 2008.

Turnover

Trading volumes on exchanges witnessed phenomenal growth during the 1990s. The average daily turnover grew from about Rs 1.50 billion in 1990 to Rs 120 billion in 2000, peaking at over Rs 200 billion. One-sided turnover on all stock exchanges exceeded Rs 10 trillion during 1998–99, Rs 20 trillion during 1999–2000 and approached Rs 30 trillion during 2000–01 (Table 2.11). However, it declined substantially to Rs 9.7 trillion in 2002–03 to almost double in the next year to Rs 16.2 trillion. It increased to Rs 51.3 trillion in 2007–08. The turnover ratio, which reflects the volume of trading in relation to the size of the market, has risen significantly since the advent of the screen-based trading system in 1995.

The relative importance of various stock exchanges in the market has undergone dramatic change since the advent of NSE in 1994. The increase in turnover took place mostly at the big exchanges and it was partly at the

³ One stock broker Ketan Parekh manipulated markets by colluding with other brokers and promoters. Investors panicked and the markets showed a free fall once this fraud was exposed in 2000–01.

⁴ After 1999, data on market capitalization are available only for the NSE and BSE, since there are practically no trades on other exchanges.

Table 2.11: Secondary Securities Market in India—Select Indicators

(Amount in Rs crore)

At the end of financial year	Cash segments of stock exchanges							
	No. of brokers	No. of listed companies	S&P CNX Nifty index	Market Cap	Market Cap ratio (%)	One-sided turnover	Turnover ratio (%)	Derivatives turnover
1991–92	—	6,480	1261.65	3,54,106	57.4	—	—	0
1992–93	5290	6,925	660.51	2,28,780	32.4	—	—	0
1993–94	6413	7,811	1177.11	4,00,077	45.6	2,03,703	50.9	0
1994–95	6,711	9,077	990.24	4,73,349	45.6	1,62,905	34.4	0
1995–96	8,476	9,100	985.30	5,72,257	47.0	2,27,368	39.7	0
1996–97	8,867	9,890	968.85	4,88,332	34.6	6,46,116	132.3	0
1997–98	9,005	9,833	1116.65	5,89,816	37.7	9,08,681	154.1	0
1998–99	9,069	9,877	1078.05	5,74,064	34.1	10,23,382	178.3	0
1999–00	9,192	9,871	1528.45	11,92,630	84.7	20,67,031	173.3	0
2000–01	9,782	9,954	1148.20	7,68,863	54.5	28,80,990	374.7	4,018
2001–02	9,687	9,644	1129.55	7,49,248	36.4	8,95,818	119.6	1,03,848
2002–03	9,519	9,413	978.20	6,31,921	28.5	9,68,909	153.3	4,42,333
2003–04	9,368	9359	1771.90	13,18,795	52.3	16,20,932	122.9	21,42,269
2004–05	9,129	—	2035.65	1702136	54.41	16,66,896	98.1	25,64,127
2005–06	9335	—	3402.55	30,22,190	85.58	23,90,103	79.1	48,24,259
2006–07	9443	—	3821.55	35,48,808	86.02	29,01,472	81.8	74,15,278
2007–08	9,487	—	4734.50	51,41,368	109.09	51,30,816	99.79	1,33,32,787

Source: Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI), National Stock Exchange (NSE), and Bombay Stock Exchange (BSE).

Note: Turnover figures for the respective years indicate information not available or no trading. Market capitalization up to 1998–99 refers to all Indian exchanges and from 1999–2000, it refers to securities listed on NSE and BSE only. Market Cap is all India Market Cap.

cost of small exchanges that failed to keep pace with the changes (Appendix 2A.III). NSE is the market leader with over 69 percent of the total in 2007–08. The top two stock exchanges together accounted for 99.98 percent of turnover, while the rest reported almost nil turnovers during the year. The big exchanges now report higher turnover from their trading terminals in the home turf of most of the corresponding local exchanges.

Sectoral Composition of Turnover

The sectoral distribution of turnover has undergone significant change over the last few years. The share of manufacturing companies in the turnover of the top 50 companies, which was nearly 80 percent in 1995–96, declined sharply to about 2 percent in 2002–03. During the same period, the share of IT companies in turnover increased sharply from nil in 1995–96 to 75 percent in 2002–03. The year 2003–04, however, presented a balanced composition with manufacturing and IT sectors having shares of 38 percent and 31 percent, respectively. During 2007–08, infrastructure had the highest share of 22.9 percent in turnover of the top 50 companies listed on the NSE, followed by manufacturing with a share of 19.7 percent, petrochemicals 17.8 percent, and financial services 11.7 percent. IT sector had a share of 5.9 percent only. Traditionally, manufacturing companies and the financial services sector accounted for a major share in market capitalization. However, the importance of these sectors has declined in the current decade and new sectors like information technology, pharmaceuticals, and fast-moving consumer goods have picked up. The sectoral distribution has changed further in the recent past. At the end of 2007–08, petrochemicals had the highest share of 22.9 percent in market capitalization of the top 50 companies listed on the NSE, followed by manufacturing with a share of 22.51 percent, and the infrastructure sector with a share of 17.05 percent.

Trading Concentration

Secondary market trading in India is concentrated among a few securities and a few brokers (see Table 2.12). For example, in 2007–08, the top five securities accounted for 18 percent of turnover on the NSE and the top 100 securities represented 81 percent of turnover. During the same period, the top 5 and top 100 brokers accounted for 15 percent and 74 percent of total turnover, respectively. In general, the concentration of turnover by securities has declined since the mid 1990s—concentration of turnover among brokers has increased. The share of the five securities with the highest turnover shrank from 85 percent of total turnover in 1996–97 to 18 percent in 2007–08,

Table 2.12: Concentration of Trading on the National Stock Exchange

Year	% of trades accounted for by				
	Top 5	Top 10	Top 25	Top 50	Top 100
Securities					
1994-95 (Nov.-Mar.)	48.77	55.92	68.98	81.14	91.07
1995-96	82.98	86.60	90.89	93.54	95.87
1996-97	84.55	91.96	95.70	97.03	98.19
1997-98	72.98	85.17	92.41	95.76	97.90
1998-99	52.56	67.11	84.71	92.03	95.98
1999-2000	39.56	59.22	82.31	88.69	93.66
2000-01	52.15	72.90	88.93	94.57	97.46
2001-02	44.43	62.92	82.24	91.56	95.91
2002-03	40.58	55.41	77.8	89.16	95.38
2003-04	31.04	44.87	64.32	79.44	91.03
2004-05	25.88	41.65	57.98	72.4	84.26
2005-06	22.15	31.35	46.39	59.22	73.12
2006-07	18.49	28.44	48.57	66.57	82.24
2007-08	18.37	28.93	48.16	65.02	81.01
Members					
1994-95 (Nov.-Mar.)	18.19	26.60	44.37	61.71	81.12
1995-96	10.65	16.56	28.61	41.93	58.59
1996-97	5.94	10.08	19.67	30.57	45.95
1997-98	6.29	10.59	18.81	29.21	44.24
1998-99	7.73	11.96	20.77	31.66	47.02
1999-2000	7.86	12.99	22.78	34.41	49.96
2000-01	7.78	12.76	23.00	33.86	48.79
2001-02	7.14	12.29	23.63	36.32	53.40
2002-03	10.26	16.41	29.07	42.49	59.15
2003-04	11.58	17.36	30.34	44.05	61.37
2004-05	13.52	20.2	34.97	49.01	65.09
2005-06	14.62	25.57	38.17	52.57	68.45
2006-07	15.63	25.49	43.63	57.59	72.04
2007-08	15.03	25.82	44.78	60.35	74.39

Source: NSE.

while the share of the 100 securities with the highest turnover declined from 98 percent to 81 percent of total turnover. Between 1996-97 and 2007-08, the top five members accounted for only 15 percent of turnover and the top 100 members accounted for 46 percent of total turnover.

Trading Frequency

Trading is concentrated among a limited number of stocks and it is very thin in several stocks; many listed securities are not traded at all and trading

in many others is negligible. While 90.6 percent of companies listed on the BSE were traded on more than 100 days during 2007–08, 3 percent of companies were traded on fewer than 10 days in the year. In contrast, 93 percent of NSE stocks were traded for more than 100 days during 2007–08. (see Table 2.13)

Table 2.13: Trading Frequency of Listed Securities in 2007–08

No. of days traded	BSE		NSE	
	No.	%	No.	%
> 100	2868	90.59	1177	92.97
51–100	89	2.81	47	3.71
11–50	106	3.34	35	2.76
≤ 10	103	3.25	7	0.55
Total	3166	100.00	1266	100.00

Source: SEBI.

Institutional Participation

Institutional investors are generally seen as more knowledgeable than individual investors given their ability to support research, and retail investors, as well as market movements, are believed to follow the transactions of institutional investors, particularly FIIs. Institutional investors have been increasing their participation in India's markets. Until as recently as January 2008, they were not allowed to short sell securities and they could undertake only delivery-based transactions. In 2007–08, institutions (including FIIs, mutual funds, banks, DFIs, and insurance companies) accounted for about one-fourth of the total cash turnover on the NSE (see Table 2.14). This was up from about 14 percent in 2004–05 and it broadly corresponds to the share of institutional holdings in companies. Retail investors, on the other hand, account for 50 percent of turnover on the NSE, while they hold about 10 percent of shares in companies.

Returns in Indian Markets

The two most widely cited indices to track market performance in India are the BSE Sensex and the S&P CNX Nifty. The Sensex, or Bombay Stock Exchange Sensitive Index, is a value-weighted index of 30 large, actively

Table 2.14: Turnover on NSE Cash and Derivatives Markets by Type of Participant,
2004–05 to 2007–08 (% of Total Turnover)

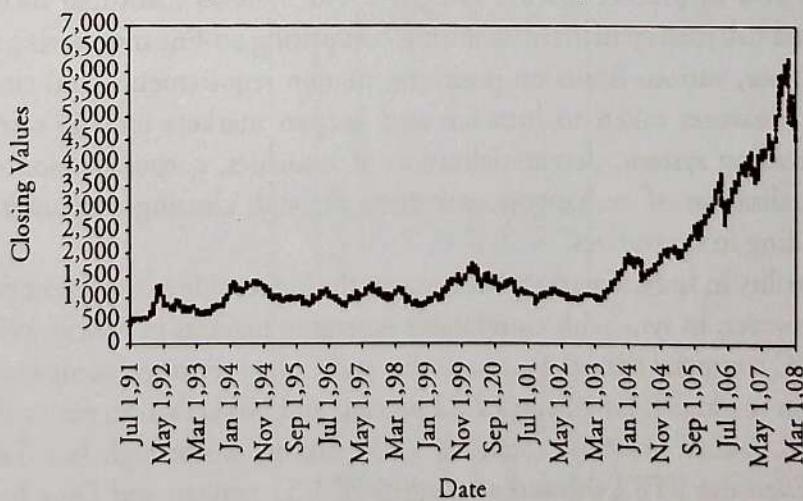
Participants	2004–05		2005–06		2006–07		2007–08	
	Cash	Derivatives	Cash	Derivatives	Cash	Derivatives	Cash	Derivatives
FII	10.34	4.46	12.48	6.68	17.05	8.74	17.89	9.54
MF	2.25	0.09	3.99	0.42	5.09	0.91	4.58	1.06
Banks	0.55	–	0.81	–	0.74	–	0.61	–
DFI and Insurance	1.08	–	0.96	–	1.39	–	1.74	–
Proprietary	33.49	38.48	24.26	30.56	24.25	27.84	24.54	24.58
Retail	52.30	56.97	57.50	62.33	51.48	62.50	50.65	64.81
Total	100	100	100	100	100	100	100	100

Source: NSE.

traded stocks from various sectors. The S&P CNX Nifty, or simply Nifty, is a diversified index of 50 large company stocks on the NSE, representing 22 sectors of the economy. It is maintained by India Index Services and Products Ltd (IISL).

Here we refer to the S&P CNX Nifty to get an overview of market performance (see Figure 2.3). In the very first year of India's liberalization, 1991–92, the Nifty soared 267 percent, and then declined sharply 47 percent in the next year as certain irregularities in securities transactions were noticed. The market experienced a roller coaster ride until 1999–2000 when the Nifty firmed up by 42 percent, due to improved perceptions about the strength of the government and its commitment towards second-generation reforms, improved macroeconomic parameters, and better corporate results. The trend reversed during 2000–01, which witnessed large sell-offs in new economy stocks in global markets and on domestic bourses, deceleration in the growth of the domestic economy, and market turbulence following allegations of large-scale irregularities in securities transactions. The decline continued further, during 2001–02, with the introduction of rolling settlement and the withdrawal of all deferral products in July 2002, suspension of the repurchase facility under UTI's US-64 scheme, the terrorist attack on the World Trade Centre in September 2001, and so on. In 2003–04, following all-round development and robust economic fundamentals coupled with a feel-good factor and huge FII inflows, the Nifty firmed up by 81 percent. The markets witnessed both unprecedented buoyancy (in 2007 for instance) and steep corrections (in 2008) in the years since.

Figure 2.3: Movement of Nifty 50



Source: NSE.

Both of India's benchmark indices made several records in 2007–08. The Sensex and the Nifty peaked at 6,357.10 and 21,206.77 on January 8, 2008 and January 10, 2008, respectively. The global recession and the international financial market turmoil coupled with domestic inflation brought these indices down in the last quarter of 2008.

The equity market has been yielding higher returns (see Table 2.15) historically in comparison to any other asset class. The market represented by the Nifty returned 24 percent during 2007–08 and 616 percent over a 15-year time horizon. The financial sector has yielded the highest returns among various sectors.

Volatility

Volatility is inherent in any market, including capital markets. India is not unique in experiencing volatility. It is an outcome of the perceptions of investors—domestic and overseas, retail and institutional—about the economy, the sector, and the company. This perception is influenced by many factors including the macro-economic environment, the growth potential of the economy, policy credibility of the government, corporate performance, domestic and international events, and market sentiments.

The authorities (Government, SEBI, and Exchanges) do not try to manage or control volatility. They endeavor to build systems and practices and to deepen and broaden markets which can withstand volatility. They have put in place systems and practices to promote a safe, transparent, and efficient market and to protect market integrity. The systems instituted include advanced risk management mechanisms comprising on-line monitoring and surveillance, various limits on positions, margin requirements, and circuit filters. Measures taken to broaden and deepen markets include screen-based trading system, dematerialization of securities, corporatization and demutualization of exchanges, settlement through clearing corporations, and trading in derivatives.

Volatility in Indian markets has been on the higher side in the recent past. It is, however, in sync with comparable emerging markets in Asia as well as the BRIC countries (Brazil, Russia, India, and China). Further, compared to the Asian markets (Hang Seng's 2.22 percent and Nikkei's 1.56 percent) in 2007–08, Indian volatility (Sensex's 1.93 percent) is not high (see Table 2.16). Even the FTSE showed a volatility of 1.37 percent and Dow Jones of 1.10 percent. If volatility is seen in the context of returns, as risk and

Table 2.15: Returns in Indian Market

Market/Segment	Return (%) as on 31st March 2008						
	One year	Two years	Three years	Four years	Five years	Ten years	Fifteen years
Nifty	23.89	39.15	132.58	167.20	384.00	323.90	616.79
Nifty Junior	15.96	24.39	86.56	135.13	533.22	495.47	NA
Nifty 500	21.64	31.46	115.80	162.49	445.50	434.68	621.34
IT Sector	-28.49	-14.89	26.75	91.24	147.54	982.63	NA
Finance Sector	60.06	125.33	389.31	603.37	1464.35	1718.67	1028.48
Petrochemicals	45.30	38.98	101.85	91.06	275.70	465.07	698.94
Services Sector	8.59	31.69	103.16	160.62	375.35	NA	NA

Source: NSE and BSE.

Table 2.16: Volatility in Stock Markets

<i>Indices</i>	<i>2000–01</i>	<i>2001–02</i>	<i>2002–03</i>	<i>2003–04</i>	<i>2004–05</i>	<i>2005–06</i>	<i>2006–07</i>	<i>2007–08</i>	<i>2008–09</i>
Nifty	1.98	1.40	0.99	1.43	1.64	1.04	1.78	2.03	2.66
Sensex	2.15	1.50	1.01	1.35	1.48	1.03	1.74	1.93	2.80
Nikkei	1.61	1.82	1.53	1.40	1.06	1.08	1.14	1.56	2.9
Hang Seng	0.80	1.70	1.17	1.07	0.96	0.72	1.05	2.22	3.1
Shanghai	0.97	1.68	1.30	1.13	1.31	1.30	1.72	2.33	
Dow Jones	1.24	1.29	1.68	0.83	0.65	0.64	0.65	1.10	2.6
FTSE 100	1.16	1.27	1.92	0.87	0.60	0.58	0.84	1.37	2.4

Source: Bloomberg and SEBI Bulletin for 2007–08 figures.

return are positively correlated, the Indian market does not seem to display higher volatility.

Dematerialization of Securities

The dematerialization of securities that SEBI initiated in 1996 with trading and settlement incentives has been quite successful. At the end of the year 2007–08, the NSDL and the CDSL had 66 participants (DPs) offering depository services and these depositories have about 14 million investor accounts in total (see Table 2.17).

INVESTOR PROTECTION

Protecting the interests of securities investors, including small investors, was the primary mandate of the SEBI when it was established by the Securities and Exchange Board of India Act, 1992. The act empowered SEBI to register and regulate all kinds of intermediaries and participants, as well as prescribe the standards and systems for safe transactions in the market. Since its inception, SEBI has taken various measures to carry out this mandate. It has framed regulations to register market intermediaries and regulate their conduct and operations. It has framed regulations relating to insider trading, fraudulent and unfair practices, substantial acquisition of shares and takeovers, and so on, to prevent any kind of market manipulation. It has also framed regulations to provide for the establishment of the office of Ombudsman to redress the grievances of investors in securities. It operates an investor grievance redressal mechanism. It takes appropriate enforcement actions against entities/individuals found to have violated securities laws.

It has been the endeavor of the authorities to make all relevant information available to investors and encourage them to use the information to make informed investment decisions. SEBI and market participants are undertaking a massive awareness program to educate investors about the precautions they need to take while dealing in securities, and how to seek redressal of their grievances, through periodic investor education workshops from SEBI and short courses offered by the NSE. The authorities continuously review market design, practices, and systems to make the market safer. Some key measures taken in this regard include screen-based trading system, dematerialization of

Table 2.17: Growth of Dematerialization

At the end of the period	NSDL		CDSL	
	DPs	DP locations (Rs crore)	DPs	DP locations (Rs crore)
1996-97	24	2	N/A	N/A
1997-98	49	200	176	0.11
1998-99	84	750	711	4.32
1999-2000	124	1,425	1,550	23.22
2000-01	186	1,896	3,721	34.21
2001-02	212	1,648	5,167	37.18
2002-03	213	1,718	3,28,912	6,876
2003-04	214	1,719	6,60,366	8,369
2004-05	216	2,819	10,70,460	12,866
2005-06	223	3,017	24,78,941	17,472
2006-07	240	5,599	31,42,645	20,270
2007-08	251	7,204	43,76,953	23,690
2008-09	274	8,777	29,87,515	27,782
2009-10	274	8,777	29,87,525	27,782
2010-11	274	8,777	3,83,525	7,373
2011-12	274	8,777	5,90,039	4,982
2012-13	274	8,777	2,93,900	3,125
2013-14	274	8,777	2,35,800	2,722
2014-15	274	8,777	1,20,959	1,908
2015-16	274	8,777	1,06,443	1,401
2016-17	274	8,777	36,164	821
2017-18	274	8,777	24,337	482
2018-19	274	8,777	10,906	1,281
2019-20	274	8,777	N/A	N/A
2020-21	274	8,777	N/A	N/A
2021-22	274	8,777	N/A	N/A
2022-23	274	8,777	N/A	N/A
2023-24	274	8,777	N/A	N/A
2024-25	274	8,777	N/A	N/A
2025-26	274	8,777	N/A	N/A
2026-27	274	8,777	N/A	N/A
2027-28	274	8,777	N/A	N/A
2028-29	274	8,777	N/A	N/A
2029-30	274	8,777	N/A	N/A
2030-31	274	8,777	N/A	N/A
2031-32	274	8,777	N/A	N/A
2032-33	274	8,777	N/A	N/A
2033-34	274	8,777	N/A	N/A
2034-35	274	8,777	N/A	N/A
2035-36	274	8,777	N/A	N/A
2036-37	274	8,777	N/A	N/A
2037-38	274	8,777	N/A	N/A
2038-39	274	8,777	N/A	N/A
2039-40	274	8,777	N/A	N/A
2040-41	274	8,777	N/A	N/A
2041-42	274	8,777	N/A	N/A
2042-43	274	8,777	N/A	N/A
2043-44	274	8,777	N/A	N/A
2044-45	274	8,777	N/A	N/A
2045-46	274	8,777	N/A	N/A
2046-47	274	8,777	N/A	N/A
2047-48	274	8,777	N/A	N/A
2048-49	274	8,777	N/A	N/A
2049-50	274	8,777	N/A	N/A
2050-51	274	8,777	N/A	N/A
2051-52	274	8,777	N/A	N/A
2052-53	274	8,777	N/A	N/A
2053-54	274	8,777	N/A	N/A
2054-55	274	8,777	N/A	N/A
2055-56	274	8,777	N/A	N/A
2056-57	274	8,777	N/A	N/A
2057-58	274	8,777	N/A	N/A
2058-59	274	8,777	N/A	N/A
2059-60	274	8,777	N/A	N/A
2060-61	274	8,777	N/A	N/A
2061-62	274	8,777	N/A	N/A
2062-63	274	8,777	N/A	N/A
2063-64	274	8,777	N/A	N/A
2064-65	274	8,777	N/A	N/A
2065-66	274	8,777	N/A	N/A
2066-67	274	8,777	N/A	N/A
2067-68	274	8,777	N/A	N/A
2068-69	274	8,777	N/A	N/A
2069-70	274	8,777	N/A	N/A
2070-71	274	8,777	N/A	N/A
2071-72	274	8,777	N/A	N/A
2072-73	274	8,777	N/A	N/A
2073-74	274	8,777	N/A	N/A
2074-75	274	8,777	N/A	N/A
2075-76	274	8,777	N/A	N/A
2076-77	274	8,777	N/A	N/A
2077-78	274	8,777	N/A	N/A
2078-79	274	8,777	N/A	N/A
2079-80	274	8,777	N/A	N/A
2080-81	274	8,777	N/A	N/A
2081-82	274	8,777	N/A	N/A
2082-83	274	8,777	N/A	N/A
2083-84	274	8,777	N/A	N/A
2084-85	274	8,777	N/A	N/A
2085-86	274	8,777	N/A	N/A
2086-87	274	8,777	N/A	N/A
2087-88	274	8,777	N/A	N/A
2088-89	274	8,777	N/A	N/A
2089-90	274	8,777	N/A	N/A
2090-91	274	8,777	N/A	N/A
2091-92	274	8,777	N/A	N/A
2092-93	274	8,777	N/A	N/A
2093-94	274	8,777	N/A	N/A
2094-95	274	8,777	N/A	N/A
2095-96	274	8,777	N/A	N/A
2096-97	274	8,777	N/A	N/A
2097-98	274	8,777	N/A	N/A
2098-99	274	8,777	N/A	N/A
2099-2000	274	8,777	N/A	N/A
2000-01	186	1,896	3,721	128
2001-02	212	1,648	5,167	148
2002-03	213	1,718	3,28,912	6,876
2003-04	214	1,719	6,60,366	8,369
2004-05	216	2,819	10,70,460	12,866
2005-06	223	3,017	24,78,941	17,472
2006-07	223	3,017	31,42,645	20,270
2007-08	240	5,599	43,76,953	23,690
2008-09	251	7,204	43,76,953	23,690
2009-10	251	7,204	93,72	410
2010-11	251	7,204	4,178	358
2011-12	251	7,204	2,577	304
2012-13	251	7,204	1,150	1530
2013-14	251	7,204	630	1530
2014-15	251	7,204	630	1530
2015-16	251	7,204	630	1530
2016-17	251	7,204	630	1530
2017-18	251	7,204	630	1530
2018-19	251	7,204	630	1530
2019-20	251	7,204	630	1530
2020-21	251	7,204	630	1530
2021-22	251	7,204	630	1530
2022-23	251	7,204	630	1530
2023-24	251	7,204	630	1530
2024-25	251	7,204	630	1530
2025-26	251	7,204	630	1530
2026-27	251	7,204	630	1530
2027-28	251	7,204	630	1530
2028-29	251	7,204	630	1530
2029-30	251	7,204	630	1530
2030-31	251	7,204	630	1530
2031-32	251	7,204	630	1530
2032-33	251	7,204	630	1530
2033-34	251	7,204	630	1530
2034-35	251	7,204	630	1530
2035-36	251	7,204	630	1530
2036-37	251	7,204	630	1530
2037-38	251	7,204	630	1530
2038-39	251	7,204	630	1530
2039-40	251	7,204	630	1530
2040-41	251	7,204	630	1530
2041-42	251	7,204	630	1530
2042-43	251	7,204	630	1530
2043-44	251	7,204	630	1530
2044-45	251	7,204	630	1530
2045-46	251	7,204	630	1530
2046-47	251	7,204	630	1530
2047-48	251	7,204	630	1530
2048-49	251	7,204	630	1530
2049-50	251	7,204	630	1530
2050-51	251	7,204	630	1530
2051-52	251	7,204	630	1530
2052-53	251	7,204	630	1530
2053-54	251	7,204	630	1530
2054-55	251	7,204	630	1530
2055-56	251	7,204	630	1530
2056-57	251	7,204	630	1530
2057-58	251	7,204	630	1530
2058-59	251	7,204	630	1530
2059-60	251	7,204	630	1530
2060-61	251	7,204	630	1530
2061-62	251	7,204	630	1530
2062-63	251	7,204	630	1530
2063-64	251	7,204	630	1530
2064-65	251	7,204	630	1530
2065-66	251	7,204	630	1530
2066-67	251	7,204	630	1530
2067-68	251	7,204	630	1530
2068-69	251	7,204	630	1530
2069-70	251	7,204	630	1530
2070-71	251	7,204	630	1530
2071-72	251	7,204	630	1530
2072-73	251	7,204	630	1530
2073-74	251	7,204	630	1530
2074-75	251	7,204	630	1530
2075-76	251	7,204	630	1530
2076-77	251	7,204	630	1530
2077-78	251	7,204	630	1530
2078-79	251	7,204	630	1530
2079-80	251	7,204	630	1530
2080-81	251	7,204	630	1530
2081-82	251	7,204	630	1530
2082-83	251	7,204	630	1530
2083-84	251	7,204	630	1530
2084-85	251	7,204	630	1530
2085-86	251	7,204	630	1530
2086-87	251	7,204	630	1530
2087-88	251	7,204	630	1530
2088-89	251	7,204	630	1530
2089-90	251	7,204	630	1530
2090-91	251	7,204	630	1530
2091-92	251	7,204	630	1530
2092-93	251	7,204	630	1530
2093-94	251	7,204	630	1530
2094-95	251	7,204	630	1530
2095-96	251	7,204	630	1530
2096-97	251	7,204	630	1530
2097-98	251	7,204	630	1530
2098-99	251	7,204	630	1530
1999-2000	251	7,204	630	1530
2000-01	186	1,896	3,721	128
2001-02	212	1,648	5,167	148
2002-03	213	1,718	3,28,912	6,876
2003-04	214	1,719	6,60,366	8,369
2004-05	216	2,819	10,70,460	12,866
2005-06	223	3,017	24,78,941	17,472
2006-07	223	3,017	31,42,645	20,270
2007-08	240	5,599	43,76,953	23,690
2008-09	251	7,204	93,72	410
2009-10	251	7,204	6,372	358
2010-11	251	7,204	4,178	304
2011-12	251	7,204	2,577	1530
2012-13	251	7,204	1,150	1530
2013-14	251	7,204	630	1530
2014-15	251	7,204	630	1530
2015-16	251	7,204	630	1530
2016-17	251	7,204	630	1530
2017-18	251	7,204	630	1530
2018-19	251	7,204	630	1530
2019-20	251	7,204	630	1530
2020-21	251	7,204	630	1530
2021-22	251	7,204	630	1530
2022-23	251	7,204	630	1530
2023-24	251	7,204	630	1530
2024-25	251	7,204	630	1530
2025-26	251	7,204	630	1530
2026-27	251	7,204	630	1530
2027-28	251	7,204	630	1530
2028-29	251	7,204	630	1530
2029-30	251	7,204	630	1530
2030-31	251	7,204	630	1530
2031-32	251	7,204	630	1530
2032-33	251	7,204	630	1530
2033-34	2			

securities, T+2 rolling settlement, settlement through clearing corporations, high corporate governance standards, advanced risk management mechanism, disclosure of relevant information, and so on.

Several agencies maintain multiple funds that provide for investor education and protection. These include the Investor Education and Protection Fund provisions made for individual companies in the Companies Act and similar funds maintained by SEBI and individual exchanges. The provisions of these funds are discussed below.

Investor Education and Protection Fund for Companies

Section 205C of the Companies Act, 1956 provides for the establishment of the Investor Education and Protection Fund. The following amounts that remain unpaid and unclaimed, for a period of seven years from the date they became due for payment, are credited to the fund:

1. amounts in the unpaid dividend accounts of the companies;
2. the application moneys received by companies for allotment of any securities and due for refund;
3. matured deposits with companies;
4. matured debentures with companies;
5. the interest accrued on the amounts referred to in clauses 1 to 4;
6. grants and donations given to the fund by the Central Government, State Governments, companies, or any other institutions for the purposes of the fund; and
7. the interest or other income received out of the investments made from the fund.

The objectives of IEPF are:

1. educating investors about market operations;
2. equipping investors to analyze information to take informed decisions;
3. making investors knowledgeable about market volatilities;
4. empowering the investors by making them aware of their rights and responsibilities under various laws;

5. continuously disseminating information about unscrupulous elements and unfair practices in securities market; and
6. broadening the investors' base by encouraging new investors to participate in the securities market.

Investor Protection and Education Fund of SEBI

SEBI has set up a fund with an initial corpus of Rs 0.1 billion. The fund is credited by (a) grants and donations given by the Central Government, State Governments, or any institution approved by SEBI; (b) interest or other income received out of the investments made from the fund; and (c) such other amount that SEBI may specify in the interests of the investors. SEBI is in the process of framing regulations to maintain the transparency in the administration of this fund and for the proper utilization of the fund for the purposes of investor protection and education.

In the Union Budget for 2006–07, it was proposed to set up an investor protection fund under the aegis of SEBI, funded by fines and penalties recovered by SEBI with a view to bolstering confidence among retail investors, who should be the key drivers of the capital market. Thus, there is a proposal to empower SEBI to establish an Investor Protection Fund. All sums realized by way of monetary penalty, disgorgement, settlement of proceedings, and compounding under the securities laws shall be credited to this fund. It is proposed to credit the fund by: (a) unclaimed (for seven years) amounts of dividend or interest lying with a mutual fund, Collective Investment Scheme or Venture Capital Fund under any scheme, (b) amounts or securities of clients lying unclaimed (for seven years) with an intermediary, (c) grants and donations, (d) monies lying unutilized in investor protection funds of the exchanges, and (e) interest or other income received from investments made from the fund.

Investor Protection Fund (IPF)

Exchanges maintain an IPF to take care of investor claims, which may arise out of non-settlement of obligations by trading members. The IPF is used

to settle claims of investors whose trading members have been declared defaulters. Funds in the IPF are used for the following purposes:

1. IPF is mainly used to meet the claims of investors against stock brokers who have been declared as defaulters—
2. a maximum of Rs 1 million is payable to an investor in respect of his claims against defaulter broker; to pay audit fee for the audit of the funds' accounts;
3. to pay relevant statutory charges;
4. interest earned on the corpus of the fund could be used for investor education/investor services.

The contributions to the IPF, which are made by the stock exchange, include 1 percent of the listing fees received, 100 percent of the interest earned on the 1 percent security deposit kept by the issuer companies at the time of the offering of securities for subscription to the public, the difference of amount of auctions/close out price, the amount received from the proceeds from the sale of the securities written off, and the amount received under takeover regulations.

Arbitration

Arbitration is an alternative dispute resolution mechanism provided by a stock exchange for resolving disputes between the trading members and their clients that arise from trades done on the exchange. Every exchange maintains a panel of arbitrators and it provides a procedure for arbitration.

Indemnity by Depositories

The Depositories Act, 1996, and the regulations framed thereunder provide that any loss caused to the beneficial owner due to the negligence of the depository or the participant, will be indemnified by the depository. The depositories have made adequate arrangements, including insurance for indemnifying the beneficial owners for any loss that may be caused to such beneficial owners by any wrongful act, negligence, or default of the depository or its participants or of any employee of the depository, or participant.

Investor Associations

The number of investors is huge and spread across India. In order to take their inputs in policy making and to encourage them to invest with knowledge, SEBI has been empowering investor associations. It recognizes investors' associations and extends financial support for conducting investor education programs and also addresses various issues raised by these associations to protect the interests of investors. At the end of March 2008, 21 investors' associations were recognized by SEBI. These are typically local in character, and are designed to serve as investor protection and advocacy organizations.⁵

Financial Literacy Campaign

Many Indians have little or no knowledge about finance and money management. Keeping this population in mind, the NSE launched a financial literacy campaign among the students of higher secondary schools and colleges in Kerala in October 2006. The overwhelming response encouraged the roll out of this campaign on a wider scale. So far, over 4,700 financial literacy seminars have been organized in 951 institutions in the states of Kerala, Karnataka, Tamil Nadu, Andhra Pradesh, and Gujarat. Over 2,36,000 students have participated in these seminars. The seminars include a presentation of about one and a half hours on finance and financial markets made by an instructor, which is followed by a question and answer session.

India's first dedicated business and consumer television channel—CNBC Awaaz—launched *Pehla Kadam* in partnership with the NSE and NDSL in July 2007. This program is an initiative to create a platform for answering the various market-related queries which first-time investors have. It takes into account the challenges that first-time investors face while venturing into the stock market and endeavors to educate them about the intricacies involved with various aspects of financial planning, investment and risk management, importance of equities and the basics of equity markets, and similar topics.

⁵ The list of the associations are available at: <http://www.sebi.gov.in/investor/investadd.pdf>

Investment Adviser

The protection of the interests of investors requires two sets of measures—preventive and remedial. The regulation of investment advisers is a key preventive measure, which is designed to prevent unsuspecting investors making irrational decisions based on misleading advice that appears in the media. SEBI is statutorily required to register and regulate investment advisers and frame regulations for this purpose. Accordingly, SEBI has prepared a draft regulation for investment advisers in 2007 that are yet to be formally notified (as of September 2009). Upon notification, these regulations will regulate the investment advisers.⁶

KNOWLEDGE INITIATIVES

The quality of intermediation services determines the shape and health of the securities market, as the suppliers of funds/securities rely on the knowledge and expertise of the intermediaries and look to them for guidance and support. The provision of quality intermediation is necessary, not only to sustain reforms in the market, but also to maintain and enhance the confidence of investors/issuers in the market. They can have comfort if the intermediaries, as well as its employees (a) are fit and proper persons, (b) follow a certain code of conduct and behave properly, and (c) are capable of providing professional services. All the intermediaries in the securities market are registered and regulated by SEBI. Before authorizing a person to act as an intermediary, the regulator determines if he is a fit and proper person to participate in the market. In order to do so, it takes account of financial integrity, convictions or civil liabilities, competence, reputation and character, efficiency and honesty, and other aspects of the person's background. A code of conduct has been prescribed for each intermediary, as well as for its employees to respect regulations—capital adequacy and other norms has been specified; a system of monitoring and inspecting their operations has been instituted to enforce compliance; and disciplinary actions are being taken against them for violating any regulation. All the intermediaries in the market are mandated to have a compliance officer who reports independently to SEBI. Thus, a reasonably satisfactory arrangement is in place to ensure good conduct of the

⁶ The entire draft is available at: <http://www.sebi.gov.in/commreport/inv.html>.

intermediaries. As regards capability, the intermediaries need to have capable people who understand the market, regulations, and products, and can guide the investors and issuers to take appropriate decisions. This is sought to be achieved through a set of complementary initiatives, like training and certification programs, usually mandated by SEBI.

National Institute of Securities Markets

SEBI has set up an institute called the National Institute of Securities Markets (NISM) which will undertake training and certification. It would design and implement the entire gamut of educational initiatives, including education, training, certification, research, and consultancy in the area of the securities market, and allied subjects to build a cadre of securities market professionals, which is a basic infrastructure for development of the securities market. The institute has been set up with the following objectives:

1. To build knowledge base by supporting research studies and surveys in the area of securities industry.
2. To create and maintain a data/knowledge depository pertinent to securities markets of Asia, as well as other developing and developed markets.
3. To facilitate publication and dissemination of data/information/knowledge about securities markets of the world for strategic decision making by security industry professionals.
4. To cultivate an organized cadre of professionals who would be equipped to facilitate learning and to conduct research in securities industry.
5. To offer/facilitate long-term educational courses (including PhD degrees) for pre-profession target group.
6. To organize continuing education programs/seminars/conferences for security market professionals, investors, issuers, students, media fraternity, and regulatory staff.
7. To supervise/guide/undertake/facilitate quality improvement for security market participants through education and certification.
8. To collaborate with universities, school boards, media, and the security industry's interest groups to take investment education to the grass roots.
9. To play a catalytic role in creating an all-pervasive security market educational mosaic in India, as well as other developing nations.

The NISM has six schools to serve the needs of different constituencies in the market—investors, issuers, intermediaries, regulators, professionals aspiring to enter the industry, and key segments that influence public opinion. It has been made the nodal agency to establish a certification framework for securities industry under the relevant SEBI regulations. It is in the process of establishing the network for securities markets data (NSMD) to support data requirements of people who wish to undertake studies pertinent to the market.

SEBI Certifications Markets

SEBI has mandated certifications of derivative brokers and MF distributors. It has framed the Certification of Associated Persons in the Securities Markets Regulations in October 2007. The regulations seek to make mandatory the certification of employees and agents working with intermediaries in certain positions wherein they handle the investors' money, assets, complaints or grievances, attend to compliance, and deal or interact with investors/issuers. The certificate is to be obtained by passing an examination approved by SEBI. The certificate would be valid for three years. Subsequently, such persons would be required to complete an approved program of Continuing Professional Education to maintain the validity of certificate. NISM has been made responsible to coordinate the task of certification in Indian Securities Markets.

NSE Certification in Financial Markets

National Stock Exchange's Certification in Financial Markets (NCFM), a testing and certification mechanism, has become extremely popular and is sought after by candidates, as well as employers due to its unique on-line testing and certification program. It offers all the certifications mandated by SEBI, NSDL, AMFI, FIMMDA, and NSE itself. The entire process from generation of question papers, invigilation, testing, assessing, scores reporting, and certifying is fully automated; there is no human intervention. It allows tremendous flexibility and easy accessibility and convenience to candidates, as they can be tested at any time and from any location. The purpose is to

test the practical knowledge and skills that are required to operate in the financial markets, in a secure and unbiased manner.

NCFM offers a comprehensive range of modules covering many different areas in finance. Some of these modules enjoy regulatory and/or industry patronage. NCFM currently tests expertise in 17 modules. Over 6,90,000 candidates have so far appeared for various modules of NSE from over 65 cities in India and abroad.

CBSE–NSE Certification in Financial Markets

Central Board of Secondary Education (CBSE) and NSE have introduced a joint certification in Financial Markets for standard XI and XII students (the last two years of high school). This is the first ever exercise to introduce instruction toward financial literacy in schools and this would provide an early exposure to young adults to the world of finance. The course titled "Financial Markets Management" has been introduced by CBSE in the academic year 2007–08. Two financial market-related subjects, "Introduction to Financial Markets—I and II" are taught in standard XI and XII students, respectively. Students opting for the course are required to take the NCFM on-line tests in "Financial Markets: A Beginners Module" in standard XI and both the Capital Markets (Dealers) Module and Derivatives Markets (Dealers) Module in standard XII. For the first academic year, 57 schools and 1,307 students enrolled for this program, and these numbers are likely to increase substantially in the coming years.

NSE Research Initiative

The NSE administers a scheme called the NSE Research Initiative, which aims at improving market efficiency further. The initiative fosters research with a purpose to support and facilitate stock exchanges to design a market microstructure, to help participants frame their strategies, to assist regulators to frame regulations, and in general to broaden the knowledge horizon of the securities market. The initiative has received tremendous response from academia, as well as market participants from within and outside the country. Besides, NSE commissions research papers and provides data to academic researchers.

CONCLUSION: SECURITIES MARKETS IN AN ERA OF REFORMS

As documented in this chapter, India's securities markets have come a long way since the authorities set out in the early 1990s to reform the sector. The securities market was promoted as an alternative means of resource mobilization from banking dominated channels to meet the needs of a dynamic economy. Ten special legislative interventions supported the reform.

Comparing the design of the market at the outset of reform in 1992 with its status a decade and a half later, one sees just how greatly the market has changed (Appendix 2A.IV). The practice of a central authority allocating resources, as well as terms among competing entities was discontinued. Eligible parties were allowed freedom to issue the securities at market-determined rates. Merit-based regulation was replaced by disclosure-based regulation. Domestic issuers and investors were permitted to raise resources or invest outside India, and foreign issuers and investors were granted access to the Indian market. The secondary securities market overcame India's geographical constraints by moving to screen-based trading.

The fundamental institutional changes resulted in a drastic reduction in transaction costs and significant improvements in efficiency, transparency, and safety. The trading system is now accessed through 10,000 trading terminals spread across more than 400 cities and towns, and also through the Internet and hand-held mobile devices from all over the world. All kinds of securities—debt and equity, government and corporate—are traded on exchanges side by side. Trades enjoyed counter-party guarantee. The trading cycle is shortened to a day and trades are settled within two working days, while all deferral products are banned. Physical security certificates have almost disappeared. The settlement system complies with the CPSS–IOSCO recommendations and G30 recommendations in letter and spirit. A variety of derivatives are permitted. Corporate governance practices improved significantly.

Today, India's securities market is the most reformed sector of the economy and a benchmark for many markets abroad as well. During the course of reform, the securities market acquired India's first ever autonomous regulator (which eventually became the model for other regulators). It gave birth to the first demutualized stock exchange in the world. It uses sophisticated satellite-based communications technology for securities transactions. It started real-time on-line position monitoring of brokers. It was the first

to introduce the straight-through processing in securities transactions. It was among the first major markets around the globe to have implemented T+2 rolling settlement. In many areas, such as biometric-based identification of market participants, disclosure and accounting standards, and corporate governance, the Indian securities market is rated to be either the first or the best in the world today. In short, Indian securities markets have come a long way in the last decade and a half to fulfill the needs of a vibrant, rapidly growing, and steadily globalizing economy.

APPENDIX 2A.I

Select Features of the Issue of Capital and Disclosure Requirements (ICDR) Regulations, 2009

Eligibility

An unlisted company can make a public issue of equity shares or any other security convertible into equity shares, on fixed price basis or on book building basis, provided (a) it has net tangible assets of at least Rs 30 million in each of the preceding three years, (b) it has a pre-issue net worth of not less than Rs 10 million in each of the preceding three years, (c) it has a track record of distributable profits for at least three out of the preceding five years, and (d) the aggregate size of the issues made during the same financial year and the proposed issue does not exceed five times its pre-issue net worth. Further, an unlisted company cannot make an allotment if the number of prospective allottees is less than 1,000. A listed company can access the market in a financial year to raise resources up to five times of its pre-issue net worth. If the company, listed or unlisted, does not meet the above criteria, the issue can be made only if it satisfies two conditions: (a) the issue is made through book building process with at least 50 percent of the net offer to public being allotted to "Qualified Institutional Buyers" or the project has participation of at least 15 percent from FIs (of which at least 10 percent comes from appraisers) and 10 percent is allotted to QIBs; and (b) the minimum post issue face value of capital of the company is Rs 100 million or there is market making for at least two years from the date of listing. These provisions do not apply to a banking company, an infrastructure company, or a rights issue by a listed

company. Infrastructure companies are exempt from the eligibility norms if a public financial institution has appraised their project, and not less than 5 percent of the project cost is financed by any of the institutions, jointly or severally, by way of loan and/or subscription to equity.

IPO Grading

IPO grading is the grade assigned by a credit rating agency (CRA) to the IPO of equity shares or any other security which may be converted into or exchanged with equity shares at a later date. The grade represents a relative assessment of the fundamentals of that issue in relation to the other listed equity securities in India. Such grading is generally assigned on a five-point scale with a higher score indicating stronger fundamentals and vice versa.

It is compulsory for companies coming out with IPOs of equity shares to get their IPOs graded by at least one CRA. An unlisted company obtaining grading for IPO is required to disclose all the grades obtained, along with the rationale/description furnished by the credit rating agency(ies) for each of the grades obtained, in the Prospectus, Abridged Prospectus, issue advertisements, and at all other places where the issuer company is advertising for the IPO.

IPO grading is an endeavor to make additional information available for the investors in order to facilitate their assessment of equity issues offered through an IPO. It is intended to provide the investor with an informed and objective opinion expressed by a professional rating agency after analyzing factors like business and financial prospects, management quality, and corporate governance practices.

Pricing

An eligible company is free to make public/rights issue of securities of any denomination and at any price. It can issue the equity shares in the firm allotment category at a different price than the price at which net offer to the public is made, provided the former price is higher than the latter. It has option to determine the price and justify the same in prospectus or may allow investors to determine the price through book building. However, in certain circumstances (offer of 10 percent to public, issue beyond five times of the pre-issue net worth), book building is compulsory. In the former case, investors know the price in advance and the demand is known at the close of the issue. In the latter case, demand can be known at any time when the issue is open, but price is known at the close of issue.

Book Building is a price discovery mechanism based on the bids received at various prices from the investors, for which demand is assessed and then the price of the securities is discovered. The issuer is required to provide an indicative floor price and no ceiling price or a price band of 20 percent (cap in the price band should not be more than 20 percent of the floor price). The bids remain open for at least 3 and not more than 7 working days, which may be extended to a maximum of 10 working days in case the price band is revised. Only electronic bidding is permitted. Bids are submitted through syndicate members. Investors can bid at any price, while retail investors have option to bid at the cut off price. Bidding demand is displayed at the end of every day. The lead manager analyzes the demand generated and determines the issue price in consultation with the issuer.

This procedure was used for a public issue of equity for the first time in 1999–2000. The first 100 percent book building issue was made in 2001–02. Nowadays, fixed price issues have completely given way to book building issues (see Table AI.1).

Table AI.1: Book Building vs. Fixed Price Issues

Year	Share (%) of book building in		Share (%) of fixed price issues in	
	No. of issues	Amount raised	No. of issues	Amount raised
1999–2000	—	—	91	42
2000–01	—	—	88	40
2001–02	14	77	86	23
2002–03	33	24	67	75
2003–04	54	94	46	6
2004–05	66	98	34	2
2005–06	70	97	30	3
2006–07	84	98	16	1
2007–08	87	99	13	1

Source: Prime Database.

In a market environment, the price discovered is the appropriate price at that moment under the circumstances. When circumstances change, the price also changes and then it would appear that the IPO was overpriced or underpriced. A different price discovered on the day of listing or after a few months of listing from the issue price is no indication that the issue was over/under priced.

An eligible company is free to make a public or rights issue of equity shares in any denomination. However, in case of IPO by an unlisted company, the face value can be less than Rs 10 (but not less than Re. 1) if the issue price is Rs 500 or more. If the issue price is less than Rs 500, the face value shall be Rs 10.

A company making a public offer of equity shares can avail of a greenshoe option for stabilizing the post-listing price of its shares. This gives an option to allocate shares in excess of the shares included in the public issue. Its main purpose is to stabilize the post-listing price of the newly issued shares. The shares held by promoters are lent to a Stabilizing Agent (SA) and returned by the SA to them after the purpose is over. Promoters do not get any profit in this transaction. If the price of shares goes below the issue price, the SA buys shares from the market, so that the price rises and vice versa.

The guidelines permit a company to issue shares to retail individual investors at a price lower than that being offered to other categories. However, such discount shall not exceed 10 percent of the price at which securities are issued to other categories of public.

Fast Track Mechanism

With a view to reduce the costs and time associated with public issues, the guidelines provide an alternate mechanism for an issue in specified circumstances which do not compromise investor interest. These include:

e-IPO

A company can use the on-line system of exchanges for making public issues (called e-IPO). In such cases, the specified brokers collect applications and application moneys from their clients and place orders with the company to buy its securities. This operates in a manner similar to order, trading, and settlement of transactions in the secondary market where the broker is liable to discharge the obligations on behalf of its clients in time. However, the e-IPO facility has not yet been used.

Qualified Institutions' Placement

It is a form of private placement to encourage Indian companies with a listing history of at least one year to raise resources domestically by selling their securities directly to qualified institutional buyers (QIBs). The securities are issued on the basis of a placement document which contains all material information required for a public issue. However, it is issued only to select investors and a copy is filed with SEBI within 30 days of allotment. The placement size does not exceed five times the pre-issue net worth. Minimum of 10 percent of the securities are allotted to mutual funds. There are at least two allottees for an issue of size up to Rs 2.50 billion and at least five allottees for an issue size in excess of Rs 2.50 billion. No single allottee is allotted more than 50 percent of the issue size. The securities are issued at a price not less

than the higher of the average of the weekly high and low of the closing price quoted during the last six months or the average of the same during the two weeks preceding the relevant date. There is no lock-in period for the securities allotted under this route. However, there cannot be off-market transactions in such securities for a period of one year from the date of allotment. This facility, made available in 2006–07, has become very popular. During 2007–08, 36 companies used this route to raise Rs 255.25 billion, against 25 companies raising Rs 49.63 billion in the preceding year.

Fast Track Issuance

This enables a compliant listed company to make a follow-on public offering/rights issue without first filing the offer document with SEBI and the stock exchanges. A company is eligible if (a) it has a listing history of at least three years, (b) its average market capitalization of public shareholding is at least Rs 100 billion during preceding one year, (c) the annualized trading turnover of its shares has been at least 2 percent of the listed shares during preceding six months, and (d) it has redressed at least 95 percent of investor grievances.

Listing

A company cannot make a public issue unless it has made an application for listing of those securities with stock exchange(s). The Companies Act, 1956, requires a company intending to issue securities to public to seek listing on one or more stock exchanges. The SCRA requires a company seeking listing on a stock exchange to offer at least 25 percent of each class or kind of securities to the public for subscription. A company has, however, an option to offer at least 10 percent of each class or kind of securities to the public for subscription subject to the conditions that (a) minimum 2 million securities are offered to the public, (b) the size of the offer to the public is a minimum of Rs 1 billion, and (c) the issue is made only through book building method with allocation of 60 percent of the size to the qualified institutional buyers. The stock exchanges and SEBI can, however, relax listing requirements for a Government company.

The listing agreement requires a company to maintain a public holding of at least 25 percent. However, the minimum level of public shareholding at 10 percent can be maintained by (a) a company which offers or has in the past offered at the time of initial listing less than 25 percent, but not less than 10 percent of the total number of issued shares of a class or kind, and (b) a company where the number of outstanding listed shares is 20 million or more and the market capitalization of such company in respect of shares

of such class or kind is Rs 10 billion or more. This requirement seeks to ensure the availability of a minimum portion/number of shares (floating stock) of the listed securities with the public so that there is a reasonable depth in the market and the prices of the securities are not susceptible to manipulation. The requirement of continuous public shareholding does not apply to government companies, infrastructure companies, and companies referred to the BIFR.

Based on a review, the Government has recently proposed to amend the Securities Contracts (Regulation) Rules, 1957 (SCRR) to provide for both, initial and continuous listing requirements in the following manner:

1. The standards for initial listing and continued listing will be prescribed in the SCR Rules.
2. The standards for initial and continuous listing will be uniform, as the objective is the same.
3. The public offer envisaged at initial listing is of no consequence unless the public is actually allotted shares. The SCRR will prescribe in terms of allotment to public, not just public offer.
4. The word *public* is not defined. If public means *non-promoters* and includes FIs, FIIs, MFs, employees, NRIs/OCBs, private corporate bodies, and so on, the floating stock is insignificant. A view needs to be taken on this.
5. For a company to be listed and continue to be listed, it must have a public stake of 25 percent.
6. If for any reason, the public holding reduces to below 25 percent, the promoters, management, and the company may jointly and severally be liable to bring the public holding to 25 percent within three months, in the manner prescribed by SEBI, failing which appropriate enforcement action, including delisting, will be taken.
7. There should not be any discrimination between a Government company and non-Government company. The powers of the stock exchange, to relax any of the conditions of listing with the prior approval of SEBI in respect of a Government company, needs to be withdrawn. Similarly, the powers of SEBI to relax listing requirements will be withdrawn.

Allotment

An issuer company proposing to issue capital through book building has two options, namely 75 percent book building route and 100 percent book building route. In case 100 percent book building route is adopted, not more than 50 percent of net offer to public can be allocated to QIBs, not less than

35 percent to retail individual investors (an investor who applies or bids for securities of or for a value of not more than Rs 100,000) and not less than 15 percent to non-institutional investors. In case 75 percent of net public offer is made through book building, in the book built portion not less than 25 percent of the net offer to public is allocated to non-QIBs and not more than 50 percent of the net offer to QIBs (see Table AI.2). The balance 25 percent of the net offer to public, offered at a price determined through book building, is available to retail individual investors who have either not participated in book building or have not received any allocation in the book built portion. Out of the portion available for allocation to QIBs, 5 percent is reserved for allocation to mutual funds. The underwriting is compulsory if the issue is made through book building.

Table AI.2: Allotment Requirement

Mode of issue	Allotment (%) to		
	Retail individual investors (RIIs)	Qualified institutional buyer (QIBs)	Others
100% Book Building	≥ 35	≤ 50	≥ 15
75% Book Building	25	≤ 50	≥ 25
Book Building by Companies raising resources more than 5 times its pre-issue net worth	—	≥ 50	—
Book Building by Companies offering 10% of securities to public	30	60	10
Fixed Price	≥ 50	—	—

Source: SEBI.

In case of fixed price issue, a minimum 50 percent of the net offer of securities to the public is initially made available for allotment to retail individual investors. The balance is made available for allotment to individual applicants other than retail individual investors, and other investors, including corporate bodies and institutions, irrespective of the number of shares, debentures, and so on applied for.

In case of under-subscription for any category, the undersubscribed portion can be allocated to the bidders in other categories. In case of over subscription in any category, allotment is made on the basis of proportional allotment system.

Promoters' Contribution

The promoters' contribution, in case of public issues by unlisted companies and promoters' shareholding in case of "offers for sale" shall not be less than

20 percent of the post issue capital. In case of public issues by listed companies, promoters shall contribute to the extent of 20 percent of the proposed issue or should ensure post-issue holding to the extent of 20 percent of the post-issue capital. The promoters shall bring in the full amount of the promoters' contribution, including premium at least one day prior to the issue opening date. The minimum promoters' contribution is locked in for a period of three years. The contribution in excess of minimum contribution is locked in for one year. The requirement of promoter contribution does not apply in case of (a) public issue of securities by a company which is listed on a stock exchange for at least three years and has a track record of dividend payment for at least three preceding years, (b) companies where no identifiable promoter or promoter group exists, or (c) rights issues.

A listed company can make preferential issue of equity shares or other instruments convertible to equity to any select group of persons on private placement basis. Such shares can be issued at a price not less than the higher of the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the preceding six months or the average of same during the last two weeks. The instruments allotted to promoters on a preferential basis are locked in for three years. The instruments allotted to others or promoters in excess of 20 percent of capital of the company are locked in for one year.

Margin

The SEBI (DIP) Guidelines require QIBs to bring 10 percent margin. There is no such requirement for retail individual investors. However, there is no prohibition also. DIP guidelines give discretion to the Company and the merchant banker to call for margin up to 100 percent from any category of investors. The only provision in the guidelines is that a margin, if charged, shall be uniform across the same category, that is, if the company has decided to call say 50 percent from retail investors, it shall be 50 percent for all of them. As per market practice, non-QIB investors are required to bring in 100 percent margin.

Issue Process

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

A company making a public issue of securities, files a draft prospectus with SEBI through an eligible merchant banker at least 21 days prior to the filing of the prospectus with the Registrar of Companies. For a rights issue, filing of the offer document is mandatory where the aggregate value of securities, including premium if any, exceeds Rs 5 million. The letter of offer is filed with SEBI through an eligible merchant banker at least 21 days prior to the filing of the letter of offer with the Stock Exchange. Further, the company enters into an agreement with a depository for dematerialization of its securities and gives an option to subscribers/shareholders/investors to receive the security certificates either in physical or in dematerialized form.

The draft offer document filed with SEBI is made public for a period of 21 days from the date of filing the offer document with SEBI, and is filed with the stock exchanges where the securities are proposed to be listed. Further, the draft offer document is put on the websites of the lead managers/syndicate members associated with the issue and also ensures that the contents of documents hosted on the websites are the same as that of their printed versions. Twenty-one days after the draft offer document has been made public, the lead merchant banker files a statement with SEBI giving a list of complaints received, a statement as to whether it is proposed to amend the draft offer document or not, and highlighting those amendments.

In a public issue, the managing director of the designated Stock Exchange along with the post issue lead merchant banker and the registrars to the issue finalize the basis of allotment. Allotment is made on a proportionate basis within the specified categories, rounded off to the nearest integer, subject to the minimum allotment, being equal to the minimum application size as fixed and disclosed by the issuer. The proportionate basis of allotment of securities in an issue that is oversubscribed and is subject to the reservation for retail individual investors, that is, a minimum of 50 percent of the net offer of securities to the public should initially be made available for allotment to retail individual investors as the case may be. The balance net offer of securities to the public should be made available for allotment to individual applicants other than retail individual investors and other investors, including corporate bodies/institutions, irrespective of the number of shares, debentures, and so on applied for. The unsubscribed portion of the net offer to any one of these categories should be made available for allotment to applicants in the other category, if so required.

The lead merchant banker should ensure that the dispatch of share certificates/refund orders and demat credit is completed, and the allotment and listing documents submitted to the stock exchanges within two working days of finalization of the basis of allotment.

APPENDIX 2A.II

Resource Mobilization from the Primary Market

Table 2A.II.1:

<i>(Rs Crore)</i>	1991– 92	1992– 93	1993– 94	1994– 95	1995– 96	1996– 97	1997– 98	1998– 99	1999– 2000	2000– 01	2001– 02	2002– 03	2003– 04	2004– 05	2005– 06	2006– 07	2007– 08
Issues																	
Corporate Securities	16366	23537	44498	48084	36689	37147	42125	60192	72450	78396	74373	75241	74189	109297	134765	195253	322988
Domestic Issues	16366	23286	37044	41974	36193	33872	37738	59044	68963	74199	71988	71815	71091	108651	123413	178248	296432
Public/Rights Issues	11903	21651	29578	30800	22832	18806	7639	9365	7704	6362	7112	4867	7851	21892	26940	32382	83707
Private Sector	6193	19803	19330	26417	16075	10410	3138	5013	5153	4890	5692	1878	3675	13482	21154	30603	63638
Public Sector	5710	1848	10248	4383	6757	8396	4501	4352	2551	1472	1420	2989	4176	8410	5786	1789	20069
Private Placement	4463	1635	7466	11174	13361	15066	30099	49679	61259	67836	64876	66948	63901	83406	96473	145866	221725

(Appendix 2A.II Continued)

(Appendix 2A.II Continued)

(Rs Crore)

<i>Issues</i>	1991– 92	1992– 93	1993– 94	1994– 95	1995– 96	1996– 97	1997– 98	1998– 99	1999– 2000	2000– 01	2001– 02	2002– 03	2003– 04	2004– 05	2005– 06	2006– 07	2007– 08
Private Sector					4070	2493	9202	16998	19404	23106	28620	25077	18760	35794	41190	81841	129677
Public Sector					9291	12573	20896	32681	41856	44731	36256	41871	45141	47611	55284	64025	83048
Euro Issues	—	702	7898	6743	1297	5594	4009	1148	3487	4197	2385	3426	3098	3353	11352	17005	26556
Government Securities	12284	17690	54533	43231	46783	42688	67386	106067	113336	128483	152508	181979	198157	145602	181747	200198	255984
Central Government	8919	13885	50388	38108	40509	36152	59637	93953	99630	115183	133801	151126	147636	106501	160018	179373	188205
State Governments	3364	3805	4145	5123	6274	6536	7749	12114	13706	13300	18707	30853	50521	39101	21729	20825	67779
Total	28650	41227	99031	91315	83472	79835	109511	166259	185786	206879	226841	257220	272346	254253	316512	395451	578972
Mutual Funds	11253	13021	11243	11275	—5833	—2037	4064	2695	22117	11135	10120	4583	47873	2788	52482	94063	183998

Source: RBI, *Handbook of Statistics on the Indian Economy*, 2008–09.

Note: For Private Placement, data is for April 2007 to December 2008.

APPENDIX 2A.III

Growth and Distribution of Turnover on Stock Exchange (Cash Segment)

(Rs. Crore)

Exchange	1995-96	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
NSE	67287	295403	370193	414474	839052	1339510	513167	617989	1099534	1140072	1569558	1945287	3551038
BSE	50064	124190	207113	310750	686428	1000322	307292	314073	502618	518715	816074	956185	1578857
Uttar Pradesh	12373	16070	15209	18429	23876	25112	13349	14763	11751	5343	1486	799	475
Calcutta	62149	105481	178779	172818	357167	355035	27075	6523	1928	2715	2800	694	446
Ahmedabad	20626	41065	31117	29928	37566	54036	14644	15459	4545	8	0	0	0
Madras	3259	3912	2458	739	500	218	48	76	101	27	5	1	0
OTCEI	224	219	283	198	3603	126	4	0	16	0	0	0	0
Delhi	10083	48992	67936	50651	94528	82997	5526	11	3	0	0	0	0
Hyderabad	1107	480	1861	1270	1236	978	41	5	2	14	89	92	0
Bangalore	897	4389	8637	7749	1115	600	70	0	0	0	0	0	0
ICSE	—	—	—	—	274	237	70	53	0	0	91	0	0
Magadh	1629	2755	323	1	9	2	0	0	0	0	5	1	0
Bhubaneshwar	211	231	203	74	68	0	0	0	0	0	0	0	0

(Appendix 2A.III Continued)

(Appendix 2A.III Continued)

(Rs Crore)

Exchange	1995- 96	1996- 97	1997- 98	1998- 99	1999- 2000	2000- 01	2001- 02	2002- 03	2003- 04	2004- 05	2005- 06	2006- 07	2007- 08
Cochin	287	152	164	96	66	26	2	0	0	0	0	0	0
Coimbatore	5007	4798	4274	769	78	0	0	0	0	0	0	0	0
Gauhati	616	484	120	52	0	0	0	0	0	0	0	0	0
Jaipur	1048	1519	453	63	2	0	0	0	0	0	0	0	0
Ludhiana	4849	5274	8316	6070	6872	9154	964	0	0	0	0	0	0
Madhya Pradesh	202	5	1	1	10	2	16	0	0	0	0	0	0
Mangalore	39	380	314	11	0	0	0	0	0	0	0	0	0
Pune	7096	10084	8624	4827	6090	6171	1171	0	0	0	0	0	0
SKSE	452	395	17	0	0	0	0	0	0	0	0	0	0
Vadodara	2519	4344	4577	1749	159	2	20	3	0	0	0	0	0
Total	252024	670622	910972	1020719	2058699	2874528	883459	968955	1620498	1666894	2390108	2903059	5130816
NSE + BSE	117351	419593	577306	725224	1525480	2339832	820459	932062	1602152	1658787	2385632	2901472	5129895
Total (Except NSE + BSE)	134673	251029	FALSE	295495	533219	534696	63000	36893	18346	8107	4476	1587	921

Source: Annual Reports of SEBI and the exchanges for various years.

APPENDIX 2A.IV

Elements of Market Design in Indian Securities Market—1992 and 2008

<i>Features</i>	<i>1992</i>	<i>2008</i>
Corporate Securities Market		
Regulator	No Specific Regulator, but Central Government oversight.	A specialized regulator for securities market (SEBI) vested with powers to protect investors' interest and to develop and regulate securities market. SROs strengthened.
Securities	Limited number of traditional instruments	Expanded to cover government securities, units of CISs and MFs, derivatives of securities, security receipts, securitization instruments, and so on.
Form of Securities	Physical	Dematerialized
Regulatory Approach	Merit-based regulation	Disclosure-based regulation.
Intermediaries	Some of the intermediaries (stock brokers, authorized clerks and remisiers) regulated by the SROs.	A variety of specialized intermediaries emerged. They are registered and regulated by SEBI (also by SROs). They, as well as their employees are required to follow a code of conduct and are subject to a number of compliances. All participants are identified by a unique identification number.
Access to Market	Granted by Central Government	Eligible issuers access the market after complying with the issue requirements.
Disclosure	Voluntary, vague, scanty, and non-standardized	Standardized, systematic, and at par with international standards. A dedicated website for corporate disclosures.
Pricing of Securities	Determined by Central Government	Determined by market, either by the issuer through fixed price or by the investors through book building.
Access to International Market	No access	Corporates allowed to issue ADRs/GDRs and raise ECBs. ADRs/GDRs have two-way fungibility. FIIs allowed trade in Indian market. MFs also allowed to invest overseas.

(Appendix 2A.IV Continued)

(Appendix 2A.IV *Continued*)

Features	1992	2008
Corporate Compliance	Very little emphasis	Emphasis on disclosures, accounting standards, and corporate governance.
Mutual Funds	Restricted to public sector	Open to private sector and emergence of a variety of funds and schemes.
Exchange Structure	Mutual not-for-profit Exchanges	Corporate, demutual for profit Exchanges
Trading Mechanism	Open outcry, Available at the trading rings of the exchanges, opaque, auction/negotiated deals.	Screen-based trading system, orders are matched on price-time priority, transparent, trading platform, accessible from all over country.
Aggregation of order flow	Fragmented market through geographical distance. Order flow unobserved.	Order flow observed. The exchanges have open electronic consolidated limit order book (OECLOB).
Anonymity in Trading Settlement Cycle	Absent 14 day account period settlement, not adhered to always.	Complete Rolling settlement on T + 2 basis
Counterparty Risk	Present	Absent
Form of Settlement	Physical	Mostly Electronic
Basis of Settlement	Bilateral Netting	Multilateral Netting
Transfer of Securities	Cumbersome. Transfer by endorsement on security and registration by issuer.	Securities are freely transferable. Transfers are recorded electronically in book entry form by depositories.
Risk Management	No focus on risk management	Comprehensive risk management system encompassing capital adequacy, limits on exposure and turnover, VaR-based margining, client level gross margining, on-line position monitoring, and so on.
Derivatives Trading	Absent	A wide array of exchange traded derivatives; such as, futures and options on indices and select securities and futures on interest rate available.
Research	Very little	Many market participants have full-fledged research departments. Some of them have schemes/initiatives to promote research.