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Towards Competitive Securities Markets

- While presenting a bird's eye view of Indian corporate securities markets from competition perspective this article (i) brings out the role of institutions in economic growth; (ii) traces the extent of presence of features of perfect competition in various segments of the securities markets; (iii) elaborates the importance of two critical elements of competition, namely, price and competitive neutrality in securities markets and (iv) suggests a framework for competition assessment.

The securities market in India dates back to the 19th century when the securities of the East India Company were traded under a banyan tree in Mumbai and under a neem tree in Kolkata. However, the real beginning came in 1850s with the emergence of joint stock companies with limited liability. The 1860s witnessed feverish dealings in securities and reckless speculations which culminated in the black day on 1st July, 1865. This brought brokers in Mumbai together on 9th July, 1875 to form the first organized stock exchange in the country, "The Native Share and Stock Brokers' Association". The Association got permanent recognition in 1957 and has morphed to BSE Limited, one of the two major stock exchanges of India at present.

The securities market attracted heightened attention from policy makers in the 1990s when India embarked on pro-market reforms. This led to several State initiatives, including liberation of market forces along with regulations to address possible market failures in the securities market in the years that followed. Since then the market has grown exponentially as measured in terms of amount of capital raised, number of takeover of companies,

market capitalization and turnover on stock exchanges, etc. along with steep reductions in cost of transactions, and marked improvements in quality of services and choice of products. The Baseline Profitability Index ranks India as world's number one investment destination. According to a recent assessment of 27 top jurisdictions conducted by BIS and IOSCO, a total of six countries, including India, got the top most rating. It is widely believed that such outcomes could be possible primarily because of the competitive forces that the reforms unleashed into the securities market.



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This article takes a bird's eye view of Indian corporate securities markets from competition perspective without attempting any value judgement whether competition or perfect competition is necessarily good under all circumstances. Part I notes the role of institutions in economic growth, namely, securities market in an economy, and competition and regulation in securities markets. Part II traces the extent of presence of features of perfect competition in various segments of the securities markets. Part III elaborates the importance of two critical elements of competition, namely, price and competitive neutrality in securities markets. Part IV concludes with a suggested framework for competition assessment.

I. INSTITUTIONS DO MATTER

Every enquiry into the causes of wealth has reinforced the view that institutions matter. These are deeper determinants of economic growth. They determine which economy will invent and innovate and, therefore, develop and while another, similarly endowed, will not. Similar policies yield different outcomes in different economies depending on the nature and the quality of the institutions the economy has, and the difference in institutions often explains the differences in the level of income of the economies. The reforms since 1990s consciously endeavoured to build institutions wherever they did not exist, and energise the existing ones to support market-led growth. While building or rejuvenating the institutions, the reforms focused on a key institution, namely, securities market.

Several studies have established high positive association between the securities market and the real economy. The securities market serves the real economy at multiple levels: it decouples savings from investment, provides capital for innovation and entrepreneurship, allocates resources among the enterprises, and through the market for corporate control, assigns enterprises to the best managers. By so doing, it augments both savings and capital formation on the one hand and the productivity of investments on



the other thereby fostering economic growth. It yields benefits at the micro level too. For example, it enables every individual, no matter how limited are his means, to contribute to the capital of the nation's enterprises and thereby link his fortune to those of the enterprises. The securities market thus constitutes a crucial institution of a market economy.

Competition and Regulation

For growth, an economy needs a number of good quality institutions, such as, rule of law, contract enforcement, property rights, economic freedom, values and norms, etc. These institutions enable and induce economic agents to pursue their own interests, and refrain them from hindering others from doing so. These processes, called competition and regulation respectively, constitute two key institutions of a market economy. More of competition (more private provision of private goods) and strengthening of regulations (to ensure fair competition in provision of private goods) at market place constituted the key elements of the reforms of the 1990s.

An economy is an amalgam of enterprises. It performs the best only if its enterprises perform at their best. This is possible if every enterprise has full economic freedom to pursue its own interest aggressively. Since the size of the market is finite at any point of time, freedom to pursue self-interest creates fierce rivalry, known as competition in common parlance, among the enterprises to gain higher market share and realize higher profits. Each one in the same line of business tries to do better than others by improving efficiencies: technological, productive, dynamic (innovation) and so on. Some enterprises thrive, others lose and may even have to exit, but the economy always gains, for it is only the most efficient ones that survive. The reforms of the 1990s protected and promoted the freedom of economic agents to compete at the market place. The results were astounding. From a largely controlled, state-owned and inward-looking economy, India became a more liberal, more private sector led and more globalized economy. Importantly, the success of reforms reinforced faith in the market: a faith that demand for and supply of goods and services determine two major economic outcomes, namely, quantities to be produced in the economy and prices at which these are to be exchanged, in a manner that is best for the economy.

While market has come to occupy a centre-stage in economic thinking, it can and does fail at times. Market failures occur on account of presence of information asymmetry, externalities or market power and the inability of the market participants to handle them appropriately. For example, a bank may give loan to a wrong party because it knows less about the party than the party itself. Worse, the market participants may adopt unfair means of competition. If one or a few of the market participants, for example, use their market power to influence either the quantity or the price (or both) of a goods or a service, they effectively thwart competitive outcomes. To prevent this, we need regulations (along with an empowered regulator) to lay down and implement the rules of



the game, particularly the contours of economic freedom, so as to address the potential abuse of market power and consequent market failure, notwithstanding the fact that the regulations may also fail to address the market failure under certain circumstances. The regulations need to be carefully designed to strengthen the invisible hands of the market and promote competitive neutrality, and not restrict the ability of economic agents to effectively compete at the market place.

It was believed in some circles that the 2008 global financial crisis was due to a cut-throat competition among the financial market participants to outdo the other. However, the emerging consensus is that the crisis resulted from the failures in financial market regulation, and not from failure of the market itself or of competition. In fact, regulation and competition have an interesting relationship. They may complement each other to pursue the same objective (efficiency) or they may be alternate means to achieve the same objective (consumer protection). They may pursue different objectives that may occasionally work at cross purposes. For example, a high capital adequacy ratio serves the regulatory objective of stability but compromises competition objective of free entry (by disallowing enterprises without deep pockets to enter the market, even if they are more efficient than the existing ones). Similarly, a relatively low capital adequacy norm promotes the cause of competition by allowing entry of more service providers but may aggravate systemic risk. This obviously calls for an optimum level of capital adequacy which straddles the interests of both stability and efficiency of the market. Very often, a delicate balance between competition and regulation needs to be struck for the success of a market economy.

Competition and Securities Markets

Competition promotes productive efficiency of enterprises by inducing them to produce more from less. The securities market bolsters allocative efficiency by channelizing the resources to the most productive uses. While either of these efficiencies in isolation is useful, these together generate synergies at different levels. First, the securities market cannot allocate resources to the most productive uses unless the competition in product market determines those uses. Similarly, the productive uses determined by the competition in product market cannot flourish unless the securities market allocates resources for those uses. Second, the competition in product market requires free entry as and when an opportunity arises or a promising idea crops up. A person can, however, enter into product market only if he has access to capital required for entry and it can exit whenever it wishes. The securities market makes entry feasible by making risk capital available for start-ups. It enables a person to buy either the whole enterprise or buy its in pieces through purchase of securities. It also enables a person to exit an enterprise by selling either the whole enterprise or by selling it in pieces through sale of securities, in addition to using bankruptcy resolution mechanism. The coexistence of the competition and securities market triggers entrepreneurship and innovation. Third, competition is good in any market whether it is

for goods, services, securities, entities, or anything that can be exchanged. Competition in securities markets lowers the cost of capital, the cost of raising capital and the cost of transferring capital and in a sense improves the ease of doing business. It improves the efficiency of resource allocation, reduces cost of regulations and sharply penalises inefficiencies in the real sector. Fourth, freedom of every economic agent irrespective of its location to use either the domestic securities market or any of the overseas securities markets creates competition among the securities markets of the different jurisdictions. This brings in globally optimum scale and efficiency. In fact, the competitiveness of securities markets determines to a large extent the competitive edge of the nations. The reforms in the 1990s endeavours to harness these synergies.

A package of reforms consisting of measures to liberalise, regulate and develop the securities market allowed and enabled the market participants to undertake transactions on their terms. The practice of a central authority allocating resources among different competing entities as well as determining the terms of such allocation was discontinued. Domestic issuers and investors were allowed reasonable freedom and choice to raise resources and invest them within or across the borders at market determined terms. Market participants and service providers were allowed free entry and free exit. The secondary market overcame the geographical barriers by moving to screen based trading system which could be accessed through trading terminals spread across the country and more recently also through the internet and hand held mobile devices all over the world. All kinds of securities - debt and equity, government and corporate, and derivatives thereon - were traded on exchanges side by side that expanded the choice of participants. Every participant was empowered with full and correct information required to undertake transactions. The reforms essentially injected critical ingredients of competition into the securities markets in India.

II. SECURITIES MARKETS AND PERFECT COMPETITION

The securities markets transact three kinds of products, namely securities, entities (corporate control) and securities services (services required to transact securities and entities). Thus, there are three distinct, but interconnected markets, namely, market for





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securities, market for corporate control and market for securities services. Since for any transaction, it is the total transaction cost (the cost of capital plus the cost of raising capital plus the cost of transferring capital) that counts for users of any one of these markets, competition in each of these markets is important. It is useful to observe how close each of these markets is to perfect competition. The salient features of a perfectly competitive market are: every person is free to enter into and exit from the market, the market has at any time a large number of participants on both sides (buy and sell); every participant has perfect information, and no participant has the market power to set the price of the product.

Market for Securities

This section observes the extent of presence of these features in two main segments of the market, namely, primary market and secondary market, for corporate securities.

Primary Market

For years till 1992, when the Capital Issues (Control) Act, 1956 was repealed, the enterprises wishing to raise resources through issue of securities could do so only with the prior approval of the Government. After appropriating seigniorage for its own use, Government used to allocate the balance resources to 'favoured' enterprises. The 'favoured' depended on the priority of the Government of the day and/or the influence of the enterprise on the people responsible for resource allocation. Government also used to decide the amount of resources that could be raised by an enterprise and the terms of such raising. The two critical outcomes of any market, namely, quantity and price, used to be determined by a central authority and not by invisible hands of the market. Following the repeal of the Capital Issues (Control) Act, the Securities and Exchange Board of India (SEBI) came up with disclosure based regulations. These Regulations require the prospective issuers of securities to make full and accurate disclosure about themselves and their projects and products and allow the investors to make informed investment decisions. Now the market decides the quantity of resources to be allocated to each of the competing enterprises and also the terms of each such allocation, including the price of securities. This transformed the primary market as under:

(a) **Free entry and exit:** An eligible issuer may issue securities at any time following the due procedure. It is free to exit from the market at any time following the exit procedure. These procedures are respectively called listing of securities of the issuer on stock exchanges and delisting of such securities from stock exchanges. Only those issuers who continue to serve investors (buyers of securities) satisfactorily continue to remain listed on the exchanges and those failing to do so, are forced to exit. Further, every issuer has the choice to issue securities in overseas markets, in addition to or in lieu of issuing securities in domestic market.

(b) **Large participation:** The number of investors (buyers of

securities) - domestic and foreign, retail and institutional - in market for securities is very large. BSE Ltd. has about three crore registered investors. NSDL has 1.4 crore investor accounts. Over the last two decades, the number of investors has been increasing with increasing liberalisation of foreign investment regime and relatively higher growth rate of the Indian economy. The number of institutional investors and the investible resources with them is also increasing over the years. There are about 50 mutual funds, 150 alternate investment funds, and 1500 foreign portfolio investors. These investors have the option to buy in primary market and / or in secondary market and also the option to buy in Indian market and / or overseas markets. There are also a large number of sellers (issuers of securities), though not of the same scale as buyers. There are about one million companies registered in India and each of them is a potential issuer of securities, in addition to other kinds of issuers. A large variety of issuers such as companies, mutual funds, collective investment schemes, venture capital funds, promoters of companies, etc. issue a variety of securities such as equity, debentures, units of mutual funds, depository receipts, etc. Some of these are available only to institutional investors while others are available to every investor. Each of these securities has certain common fundamental features and broadly meets the same prime objective of every investor. In competition parlance, these securities are interchangeable or substitutable by investors, by reason of characteristics, prices and intended use, and, therefore, constitute the relevant product market. There is intense competition amongst a large number of sellers to sell their securities to raise resources from the relevant market. There is also an intense competition among a large number of buyers to buy securities of their choice in the relevant market. It may, however, be noted that each security is a unique product. Although the issuer of each security is, strictly speaking, a monopolist, in effect, he is part of a competitive market because of the presence of a large number of slightly differentiated securities in the relevant market.

(c) **Perfect information:** In a clear departure from the past, the securities market firmly adopted the disclosure based regulatory regime. The disclosure requirements have strengthened over time. Every issuer now makes a disclosure of full and accurate





Every issuer now makes a disclosure of full and accurate information about itself, the securities, and the rules governing transactions of such securities, based on which investors take informed decisions and assume responsibility for the same. It also makes continuous disclosures as long as the securities remain listed on stock exchanges. The disclosed information enables a potential investor to decide whether to undertake transactions in securities market, and if so, in which securities and at what prices, and through which intermediary. The disclosure regime enhances equity as all participants have equal access to the required information and no one benefits exclusively or at the cost of others from information.

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(d) No market power: Earlier, the issue price of securities used to be decided by a central authority based on its own perception of merits. In the initial days of reforms, the issuers were allowed to decide the price and justify the same in the prospectus. The issue could go through only if enough investors bought the securities at the said price. The issuers now generally adopt book building process that allows investors to discover the issue price of securities. An investor transacts at the price discovered by the invisible hands, based on its own assessment of the prospectus. This does not rule out the possibility of an issuer offering the securities at prices higher than what the market can bear, though what the market can bear is sometimes elusive. Then the transaction would not go through as there would be no buyers. There clearly remains

a possibility that a few issuers or investors join hands to manipulate prices to their advantage. This would, however, be illegal and attract penal consequences.

Secondary Market

This is the market where existing securities and derivatives on securities are traded among the investors. Till early 1990s, the stock exchanges used to have trading halls. There were about 20 such trading halls spread all over the country. Howsoever big a hall might be, it could accommodate a limited number of participants at any point of time. This obviously limited the number of participants. As a consequence, a key element of competition, namely, large number of buyers and sellers was missing. This was addressed by the introduction of screen based trading system which enables millions and millions of people spread all over the world to access the trading platform simultaneously. A typical trading system today enables processing of about 5 lakh orders in a second. It enables the participants - small or big - to trade anonymously and thereby provides equal access to everybody. No participant is big enough in this market to determine, or even influence, the price and every participant is a price taker. It allows the participants to see the whole market themselves on real time basis, making it transparent. It allows faster incorporation of price sensitive information into prevailing prices thus increasing informational efficiency of the markets. Every market participant has choice to enter or exit the market at any point of time. The screen based trading system thus allows invisible hands of the market to determine the price and the quantity of the transactions of securities. The secondary market has all the elements of perfect competition in letter and spirit. It is better than the primary market from competition perspective as it has a large number of participants even on the sale side at any time and the identity and consequently the market power of a participant is not known to any other participant. Of all components of securities markets, the secondary market for securities probably comes closest to perfect competition and its transition to this state is most remarkable.

Market for Corporate Control

The primary market enables comparison and evaluation of various alternate, competing uses of capital and ensures channelization of capital to the entities where the expected return is the highest.





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However, after the capital is allocated through primary market to an entity for a particular use, there is no guarantee that people behind the entity would always deliver the best potential return. In case they fail, the market for corporate control brings in a different set of people who can realise the full potential of the entity. This allocates entities / productive assets in the form of going concerns to the highest bidder and ensures the highest possible return on capital on a continuous basis. It infuses competitive pressures by holding the threat of bringing in more efficient/competent people to manage the entity, if the existing management runs the entity below its potential. This is how the market for control, otherwise known as 'takeover', contributes to higher return on capital and consequently, economic development.

There is a well-crafted, fair, equitable and transparent takeover mechanism in place which promotes competition for control. It is mostly a mirror image of issue of securities in primary market. Here one person buys the securities from a large number of holders of securities. The market has the very same competitive elements as the primary market has. What makes this market more competitive than the primary market is that the buyers as well as the sellers of securities have the option to buy / sell the same securities on stock exchange as well as on OTC and there is a fair and effective competition among acquirers to take over the entity by outbidding the others.

Market for Services

The market for securities uses the services of a large number and variety of service providers, namely, intermediaries (such as stock brokers), infrastructure institutions (such as stock exchanges), and technology enablers (such as STP providers) for a variety of transactions. A person meeting the eligibility norms for rendering a particular service in securities market applies to SEBI for registration as a service provider. If the applicant complies with the eligibility norms, SEBI has no option but to grant registration. Once registered as a service provider, it has the option to close the operations at any time. It can be deregistered on failure to comply with various ongoing requirements of registration. This ensures free entry and free exit of service providers and the number of such providers varies depending on what the market can bear. For example, the number of merchant bankers reduced from 155 in 2007-08 to 134 in 2008-09 only to increase to 164 in 2009-10. The market shares of service providers changes very fast from time to time and often a big one is pushed out of the market in no time. The service providers compete among themselves to do better than the others in terms of quality, choice, price, etc. and none of them, at least in theory, has the market power to determine the price for its services. Thus, the market moved from the requirement of a license to a requirement of registration and the market, rather than an exchange or the regulator, decides the number of service providers and the fees for their services. Let us look at more closely the markets for two important services.

Market for Broking

Till 1985, only individuals were allowed to provide broking services. The rules, then in vogue, prohibited a company from becoming a broker of a stock exchange. This limited the ability of a broker to service a large number of clients as well as to provide value added services. In course of time, the restriction on companies to render broking was removed. Further, the exchanges used to be mutual associations of a limited number of brokers. This was so because the number of brokers that could participate in the market was limited by the size of the trading hall and the ability of the exchange to regulate the brokers was limited. One could become a broker of an exchange only if another was quitting and hence brokership carried huge premium. Two stock exchanges (OTCEI and NSE), which came up in early 1990s with demutual structure, made brokership available on tap. With corporatisation and demutualization of stock exchanges in 2005, the brokership became available on tap in all exchanges. A person interested and eligible now acquires brokership of an exchange and also surrenders the same depending on its commercial considerations. This introduced competition among brokers which reduced broking fees to less than one tenth of what it used to be in 1990s and improved the range and quality of broking services drastically.

Market for Trading

The stock exchanges had physical trading halls where brokers used to assemble and trade securities among themselves. The law then required that every company making a public issue of securities must be listed on the regional exchange and every trade in securities in the vicinity of a stock exchange must take place on that exchange only. Hence every exchange had geographical limitations and some captive business, which precluded competition among exchanges. The country had about 25 exchanges with areas allocated to them and each exchange in some sense was a monopolist in that area.

Times changed with the infusion of technology into trading platform. Technology enabled exchanges to provide nation-wide trading facilities and even beyond, while withdrawal of various restrictions allowed the exchanges to compete among themselves. However, the technology empowered trading platform of a stock exchange carried the essentials of a natural monopoly. The trading platform is such that the initial fixed costs of setting it up is very high, while marginal cost of allowing an additional transaction is close to zero. With increase in trading volumes, the average cost of trading falls, reflecting the presence of economies of scale. Given that there is no limit to expand the processing capacity of a trading platform, particularly with increasingly potent technologies unveiled every day, the economies of scale drives trading platform towards monopoly. This tendency gets exacerbated by network externalities. Investors gravitate towards the venue which offers better liquidity. In other words, liquidity begets liquidity. An exchange which operates below the threshold of optimal liquidity is likely to lose market share while another operating above the threshold is likely to emerge dominant. This explains why the business moved away from exchanges with antiquated technologies to the



➤ Stock exchanges, in India and overseas, dole out money routinely under liquidity enhancement programmes for every trade executed on their platform, let alone charging any fee for the same. This is not considered anti-competitive as it is intended to develop the market. Thus, a similar conduct is considered anti-competitive under one circumstance and not so under another. It is not material if a service provider charges a fee or not. It is anti-competitive only if the pricing is intended to eliminate competition.

exchanges which adopted superior technology and best practices in the 1990s. As a consequence, about a dozen exchanges are reporting zero turnover over decades, while there are a handful of active exchanges in Indian securities market, with the leader having an enviable dominant position. The natural monopoly of active trading platforms serves as a strong entry barrier. A new trading platform can come up under only two circumstances, namely, (a) an existing platform loses trust of the market because of its governance failure, and / or (b) a new platform comes up with an innovation in terms of vastly superior technology, business model or product offerings.

There is a similar dominance in market for services provided by other market infrastructure institutions, such as, depositories and clearing corporations. There are a few large or dominant players in the market for some other services. The dominance usually enables a service provider to operate independently of competitive forces prevailing in the relevant market or to affect their competitors or consumers or the relevant market in their favour. It is, however, important to note that despite dominance, the competition is pretty high as evidenced by substantial decline in prices or improvement in quality of these services over the years. It may also be noted that the dominance or monopoly per se is not bad, only its abuse is. It is possible to pre-empt abuse by regulatory fiat, while benefiting the market from natural monopolies. Nevertheless, such entities need to take extra care to avoid abuse of dominance. They can't, for example, charge an unfair price for their services, deny market access to any body, or restrict scientific or technological development relating to goods or services to the prejudice of consumers. Since some of the service providers have huge assets and turnover and have a substantial market share, they must not merge or combine their businesses in a manner that causes or is likely to cause appreciable adverse effect on

competition, without approval of the Competition Commission of India (the Commission).

III. TWO CRITICAL ELEMENTS OF COMPETITION

It is useful to have a clear import of two critical elements used in the context of perfect competition.

Price

Price is a very sacrosanct element of a competitive market. Any conduct that determines price is considered anti-competitive unless justified otherwise. The prices of securities are discovered through invisible hands of the market and any attempt to render invisible hands ineffective is frowned upon. However, most of securities services are not standardised and not homogenous. The market for services does not always have a large number of participants on both sides. Let us examine a little more closely the prices of a few services in the securities market.

A stock exchange provides a number of services. A large part of its revenue in India, however, comes from the use of its trading platform. It usually levies a fee from users for use of its trading platform. In one case, a stock exchange, which was having income from fees for use of its trading platform for trading of equities and equity derivatives, did not charge any fee for use of its trading platform for trading of currency derivatives. Another stock exchange, which was providing facilities for trading of currency derivatives only, could not charge any fee as it would mean substantial loss of business. This led to an allegation of predatory pricing by the former stock exchange. The Commission considered the matter and, by a majority order, found the conduct of the former exchange to be abuse of dominance and hence anti-competitive. The matter is pending before the Supreme Court to reach finality. This may be contrasted with the fact that the stock exchanges, in India and overseas, dole out money routinely under liquidity enhancement programmes for every trade executed on





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➤ The direct transfer of benefits to consumers is preferred over subsidy through prices of goods or services because it does not distort the relative price structure and thereby does not influence the choice of consumers and / or producers in the society. In line with this principle, the securities market should offer neutral choices to market participants. It should treat all kinds of participants, products and transactions on the same level playing field. If it imposes higher transaction charges or a higher regulatory scrutiny to one kind of transaction or product as compared to another, it would distort the choice of issuers or investors in favour of some products or transactions.

their platform, let alone charging any fee for the same. This is not considered anti-competitive as it is intended to develop the market. Thus, a similar conduct is considered anti-competitive under one circumstance and not so under another. It is not material if a service provider charges a fee or not. It is anti-competitive only if the pricing is intended to eliminate competition.

It is important to put the price in right perspective. The supplier charges one price whereas the user suffers another price. For example, an exchange charges a price for use of its trading platform. However, the user suffers a price which includes user charges of an exchange. A lower user charge of a trading platform does not mean that everybody will prefer to use that platform to other platforms. One would prefer that trading platform where the aggregate cost of transaction is lower, and not where an element of transaction cost is lower. The transaction cost includes impact cost (or bid-ask spread) as well as user charges (exchange charges, depository charges, broking charges, etc.) and statutory levies (securities transaction tax, stamp duty, SEBI charges, etc.) The impact cost is very high in an illiquid market. One would not trade on a trading platform where liquidity is less even if the explicit transaction costs are lower. Similarly, one would prefer trade on a liquid platform even if explicit transaction costs are higher. This means that the charge for use of the trading platform or broking charges can be far less significant where the market is developed or liquidity has emerged.

Enterprises occasionally set the minimum prices below which the dealers / retailers are not allowed to sell their products. This is considered anti-competitive as this restricts the freedom of dealers / retailers to sell below the specified price and their ability to compete in terms of price. In contrast, the securities market has instances of prescribing maximum prices for certain services in the interests of investors. For example, the stock exchanges have specified maximum brokerage of 2.5% that can be charged by a broker. Some feel that such a prescription is anti-competitive as the maximum permissible fees may not be large enough to induce brokers to service small clients or clients in far off distant locations. However, this has not faced objection from competition perspective as the limits have been rendered irrelevant by technology and competition which together have reduced the brokerage to less than 0.1% for most of the transactions. Some feel that this level of brokerage is unviable for broking and continuing downward trend of the brokerage is detrimental to the customers in the long run. Reportedly, an association of brokers asked the regulator to set a minimum brokerage rate and that was, however, rejected as it would have been anti-investor.

Recently, the association of mutual funds has capped the upfront commission paid by asset management companies to the distributors selling schemes at 1% of the sales. This is probably intended to partially address the conflict of interests inherent in a distributor advising and selling mutual fund units simultaneously. The cap on upfront commission has in the past brought down the churning by investors. This well intentioned measure could raise concerns from competition perspective. According to press reports, this may make entry of new mutual funds difficult as they may not be able to sell units of mutual funds at this rate of commission. This may also come in the way of growth of close ended funds which do not give trail commission or on the way of mutual funds selling units in distant locations. This has, however, not come under competition lens as it is predominantly an investor protection measure.

It is extremely difficult to take a view if a particular price (or even conduct) is anti-competitive. It solely rests on the rule of reason - substantial economic reason tampered liberally with law. It is possible that the same price can be appreciated under one circumstance, but deprecated under another. Similarly, two opposite prices can invite the same fate. For example, a stock exchange may charge a positive fee, a negative fee or a zero fee for providing its services to users and none of these could be anti-competitive depending on the context. Similarly, a service provider may charge fees at different rates - lower than costs in some cases and higher than costs in some other cases - depending on the time of a transaction, volume of a transaction or strength of its relationship with a client and such differential or below cost pricing may not be anti-competitive. The regulator has set limits on prices (called circuit breakers) of each security and of the market for securities as a whole beyond which prices are not allowed to move in a day. Such limits are not considered anti-competitive



because these aim to secure market integrity. Thus, though price is the first indication of anti-competitive conduct, one needs to examine facts and circumstances surrounding each price.

Competitive Neutrality

In any public policy regime, neutrality is an important principle. The direct transfer of benefits to consumers is preferred over subsidy through prices of goods or services because it does not distort the relative price structure and thereby does not influence the choice of consumers and / or producers in the society. In line with this principle, the securities market should offer neutral choices to market participants. It should treat all kinds of participants, products and transactions on the same level playing field. If it imposes higher transaction charges or a higher regulatory scrutiny to one kind of transaction or product as compared to another, it would distort the choice of issuers or investors in favour of some products or transactions. For example, it is believed that huge turnover in derivatives in comparison to that in underlying securities is partly because the derivatives transactions attract lower securities transaction tax. It should, therefore, be the endeavour of the authorities and market infrastructure institutions to impose such taxes, fees, or regulatory burden as do not distort the choice of issuers or investors.

The ease with which one chooses one's suppliers or consumers is equally important. In the securities market context, this means that an investor can really take advantage of neutrality if it is possible for her to shift her account from one service provider to another without much hassle, similar to portability of telephone number. This would require the regulatory regime to promote costless or low cost shifting of demat account, broking account, bank account, etc. from one service provider to another. It should not be necessary for a customer to have all the three accounts with one service provider or service providers in a group. No service provider should have captive customers. This would unleash competition between the existing service provider who would try hard to retain a customer and a potential service provider who would try hard to snatch away that customer. There is reasonable competitive neutrality in this sense in case of securities. An investor can move away from one company by selling of her securities at any time she wishes.

To get a more holistic picture of competition in the securities market, we need to expand our framework to include competitors from abroad - investors as well as issuers. We need to see the market as having broadly four sets of economic agents: domestic



investors, domestic issuers, foreign issuers and foreign investors. They must have full freedom to access or provide capital within the extant capital control regime and the regulatory regime of India should not ideally distort their choice. They may choose one option over another depending on their own goals and strategy and not because regulations make one option more attractive over the other. It would mean, for example, that a foreign investor would have equal access to an Indian company regardless of whether she chooses to make direct investment in its securities or through depository receipts on its securities. Similarly, an Indian investor would have equal access to a foreign company either through direct investment in its securities or through depository receipts on its securities. The same kind of neutrality among choices should be there for issuers as well. Neutrality vis-à-vis foreign players will make Indian securities market globally more competitive, because it is only by achieving higher efficiency that it can (a) attract foreign companies and foreign investors to undertake transactions in Indian securities market, and (b) discourage domestic companies and domestic investors from undertaking transactions in securities markets overseas.

V. CONCLUSION

At least at macro level, it is evident that the principles of competition are firmly ingrained in the Indian securities markets. The degree of competition obviously differs across relevant securities markets, such as, market for each product, market for each service, market for each kind of transaction, market in each geographical location, market at a point of time, etc. It is useful to assess competition for the relevant securities market by using the parameters important from the user's perspective. A general framework of assessment at macro level is suggested in Table 1. The market segments listed in the Table are only illustrative.

It may be noted that no element included in Table 1 is sacrosanct and there can be 'n' reasons to justify presence or otherwise of any of these at a market place. The absence of a feature of competition may have a nexus to a very important purpose. Further, the user needs to consider the extent of presence of an element, as mere presence does not make a market competitive or anti-competitive. If the extent of presence of a feature is high, the market is likely to be more competitive. There can, however, be situations where excess of a feature of competition (such as disclosure of information) could be anti-competitive. The user needs to apply mind to particular facts and circumstances in a given context. She can observe herself for each relevant market as to how competitive it is in terms of requirements, features and outcomes. She can also take a view about the entire securities market by summing up her observations about each relevant market. It is important to note that outcome could be competitive even if the relevant market does not have all the features of competition. It is also important to note that a market could be competitive in the presence of market imperfections such as externalities or information asymmetry if there are arrangements to mitigate them.



Article

Towards Competitive Securities Markets

Table 1: Suggested Framework for Analysing Competition in Securities Markets

Description	Elements	Markets for				
		Securities		Control / Takeover	Services	
		Primary Market	Secondary Market		Broking	Exchange
Requirements of Competition	Freedom of Participants					
	Availability of Choices/Options					
	Free Entry of Participants					
	Free Exit of Participants					
	No Cap on Number of Participants					
	Consumer Portability					
	Mitigation of Externalities					
	Interventions for Market Failure(s)					
	Neutral Laws and Policies					
	Ease of Doing Business					
	Secure Property Rights					
	Prompt Contract Enforcement					
	Rule of Law					
Features of Competition	Large Number of Participants					
	Perfect Information Symmetry					
	Every Participant is a Price Taker					
	Free Entry of Participants					
	Free Exit of Participants					
	Standardised Products					
Market Outcomes	Normal Profits					
	No Excess Capacity					
	Choices of Consumers					
	Quality of Products					
	Low Costs and Prices					
	Innovation					
	No Dominance / Market Power					
	Less Reliance on Regulation					

SEBI is the regulator for the securities market while the Commission is the regulator across markets on matters of competition. However, both have specified responsibilities and objectives. Since their actions can affect competition in securities markets, the competition law envisages consultation between them. It is possible that SEBI, in pursuance of its objectives, comes up with a measure or a decision which may have competition concerns. Similarly, the Commission, while promoting competition in markets, may come up with a measure or decision which may have concerns for the securities market. Further, a measure or a decision may not always promote the objectives of SEBI and the Commission simultaneously. An institutional mechanism for mutual consultation is perhaps helpful to address many such issues.

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