LESSON - 5

STOCK EXCHANGES

5.0 Objective :

After studying this lesson, you should be able to :

- define stock exchange and its importance
- understand the origin, importance of Bombay Stock Exchange
- State the importance of National Stock Exchange
- Understanding scenario of various stock exchanges in the country.

Structure :

5.1 Introduction :

Secondary market is a market in which existing securities are sold/traded. This market is also known as stock market. Secondary market consists of recognised stock exchanges operating under rules by laws and regulations duly approved by Government. These stock exchanges constitute an organized market where securities issued by Central and State Governments, Public Bodies and Joint Stock Companies are traded.

5.2 Definition of Stock Exchange: Under Sec.2(3) of the securities contract (Regulations) Act of 1956 as "anybody of individuals whether incorporated or not, constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities".

5.3 Functions of Stock Exchanges :

1. Facilitate liquidity and marketability of outstanding debt and equity instruments.
2. Contribute to economic growth through allocation/mobilization of funds to the most efficient channel through disinvestments and reinvestment.
3. To provide instant valuation of securities caused by changes in internal environment.
4. Facilitate measurement of cost of capital and rate of returns of economic entities at micro level.

5. To ensure a measure of safety and fair dealing to protect investors interest.
6. To induce companies to improve performance since market price at stock exchanges reflects the performance. So, companies/ corporates strive to improve their performance.

5.3 STOCK EXCHANGES IN INDIA

5.3.1 BOMBAY STOCK EXCHANGE

Trading in securities has been in vogue in India for a little over 200 years. Transactions were in loan securities of the East India Company. Rampant speculation was a common feature even during those times. The broking community prospered as there was high rise in prices which led to a share mania during 1861–65. This bubble burst in 1865 when the American Civil War ended. The brokers realised that investor confidence in securities market could be sustained only by organizing themselves into a regulated body with defined rules and regulations. This realization resulted in formation of "The Native Share and Stock Brokers' Association', in 1875. Later, it came to be known as Bombay Stock Exchange.

Bombay Stock Exchange is a voluntary, non-profit-making association of broker members, emerged as a premier stock exchange after 1960s. BSE dominated the Indian capital market by accounting for more than 60 per cent of the all-India turnover.

Until March 1995, BSE had an open outcry system of trading. On March 14, 1995, BSE turned to electronic trading whereby brokers trade by using computers. This system is known as the BSE on-line Trading System (BOLT). The introduction of BOLT helped in improving trading volumes, significantly reducing the spread between buy and sell orders, better trading in odd lot shares, fixed income instruments, and dealings in the renunciation of rights shares.

In 1995, BOLT was limited to Mumbai, whereas NSE was operating at the national level. As a result, BSE was losing countrywide business. On October 29, 1996, SEBI allowed BSE to use its BOLT system nationwide. By 2002, BOLT is spread over 399 centres with 1,463 VSATS (Very Small Aperture Terminals) and 2,347 TWSs (Trader Work Stations).

BSE, later, set up a Central Depository System to dematerialize shares and promote demat trading.

Carry Forward Deals, or Badla

The carry forward system, or *badla*, was a unique feature of the Indian stock exchanges. *Badla* provided the facility for carrying forward the transaction from one settlement to another. In simple terms, it was the postponement of the delivery of or payment for the purchase of securities from one settlement period to another. This facility of carry forward provided liquidity and breadth to the market. *Badla* acted as a bridge between the money market and the stock market. This system also helped in moderating extreme movement of stock prices, as it facilitated short selling in a rising market and long purchases in a declining market.

Advantages

The *badla* system contributed to the increase in the volume of the trading activity at BSE as it facilitated brokers to carry forward their positions and leverage. *Badla* along with other factors such as increased network, boom periods and increased participation by retail investors was instrumental in the increase of volume of trading activity from Rs.500 crore in 1991-92 to Rs.9,000 crore in 2000. *Badla* was also a vehicle of speculation.

In March 2001, after the Ketan Parekh scam came to light and the payment crisis in the Kolkata Stock Exchange, SEBI completely banned *badla* and all deferral products – ALBM and BLESS – from July 2001. This old system has been replaced by a new system – rolling settlements.

Listing Categories

Before *badla* was resumed in 1996, there were only two categories of securities listed in BSE – the specified group of shares comprising the securitie

s in which carry forward deals were allowed and the cash group shares in which no carry forward deals were permitted. After *badla* was resumed, the size of the specified group was reduced to 32 scrips on April 3, 1996.

The BSE later decided to regroup the existing A and B group shares into three categories.

A Group : This group consists of large turnover and high floating stock, with large market capitalization. In other words, scrips included in this group are blue chip companies. Carry forward deals and weekly settlements were allowed in this group. There were 150 scrips in this group.

B1 group : This group includes scrips of quality companies with an equity above Rs.3 crore, with high growth potential and trading frequency. No carry forward facility was allowed in this group. On June 2000, there were 1,083 scrips in this group.

B2 group : This group of scrips were just like those of B1 but with a fortnightly settlement. However, in September 1996, BSE introduced weekly settlement for all scrips listed on the exchange, thus doing away with the distinction between B1 and B2 groups. This group consists of low trading volume scrips, with equity below Rs.3 crore, and surveillance measures initiated against most of them for suspected price manipulations. On June 2000, there were 3,219 scrips in this group.

Subsequently, a Z group was introduced with scrips of companies that do not meet the rules, regulations and stipulations laid down by the exchange. It is a buyer-beware company. There were some 300 scrips in the group.

A new F group pertaining to the debt market segment was started with effect from September 9, 1996.

BSE Indices

The first index launched by BSE was the BSE sensitive index (Sensex) in 1986. Since then, in the last 15 years, it has launched 13 more indices. The BSE Sensex of equity share prices was launched with the base year of 1978-79. It comprises 30 scrips. The BSE Sensex was followed by BSE National in 1989. This is a broader index comprising 100 scrips. BSE introduced two new indices during 1993-94 – BSE 200 and Dollex. BSE 200 reflects the movements in the shares of 200 selected companies from the specified and non-specified lists of BSE. The Dollex is a dollar version of the BSE 200 which has 1989-90 as its base year. BSE introduced five sectoral indices from August 1999 BSE IT Index, Bse Capital Goods Index, BSE FMCG Index, BSE Health Care Index and BSE consumer Durables Index.

Sensex Moves in the 1990s

Events	Date	BSE Close
Gulf War begins	17.1.91	1017.72
Manmohan Singh Budget I	24.7.91	1485.76
High Index 91	19.11.91	1924.15
Low Index 92	01.1.92	1957.33
Manmohan Singh Budget II	29.2.92	3017.68
High Index 92	23.4.92	4467.32
Scam exposed (Harshad)	26.4.92	3896.90
Babri Masjid demolition	10.12.92	2550.22
Manmohan Singh Budget III	27.2.93	2552.40
Low Index 93	26.4.93	2036.81
High Index 93	13.12.93	3454.81
Low Index 94	5.1.94	3454.06
Manmohan Singh Budget IV	28.2.94	4266.20
First all-time high	12.9.94	4630.54
High Index 95	2.1.95	3932.09
Manmohan Sing Budget V	15.3.95	3487.07
NSE turnover crosses BSEs	1.11.95	3488.50
Low Index 95	29.11.95	2922.16
Manmohan Singh Budget VI (Interim)	28.2.96	3494.09
BJP loses confidence vote	27.5.96	3653.10
High Index 96	14.6.96	4049.32
P.Chidambaram Budget I	22.7.96	3807.60
S&P upgrades outlook to positive	1.10.96	3226.80
Low Index 96	4.12.96	2745.06
Low Index 97	2.1.97	3225.24
P.Chidambaram Dream Budget II	28.2.97	3651.91
Fall of Deve Gowda government	31.3.97	3360.89
RIL gives 1:1 bonus	26.6.97	4116.56

High Index 97	5.8.97	4548.02
East Asian crisis	28.10.97	3934.33
Vajpayee sworn in as PM	19.3.98	3820.87
High Index 98	21.4.98	4280.96
US imposes sanctions	12.5.98	3945.13
US 64 scare	5.10.98	2878.07
Low Index 98	20.10.98	2764.16
Yashwant Sinha's Budget II	27.2.99	3399.63
Fall of Vajpayee government	17.499	3326.98
Second all-time high	14.7.99	4710.25
Sensex touches 5000 mark	8.10.99	4981.74
High of 1999	14.10.99	5075.34
New all-time high	14.2.00	6150.69
Yashwant Sinha Budget III	29.2.00	5446.98
Crash in the NASDAQ composite	14.4.00	4880.71
UTI suspends the sale and repurchase of its flagship scheme	2.7.01	3312.95
On Sept. 11, 200, terrorists attack World Trade Centre in New York, Sensex touches eight-year low	21.9.01	2600.12

Gigantic Drops of Sensex in a Day

Date	Fall (Points)	Culprits
April 28, 1992	570	Harshad Mehta involved in a scam
May 12, 1992	333	Full effect of the scam
May 9, 1992	327	National Housing Bank involved in a scam
March 31, 1997	303	Congress withdraws support to Deve Gowda's government
April 17, 1999	246	Vajpayee government falls

Of the five major falls of Sensex in a day, two can be attributed to political development and the rest to scams. Political stability and scams have, to a large extent, influenced the market investor sentiments-domestic and international.

Trade/Settlement Guarantee Fund

The Trade Guarantee Fund (TGF) of the BSE having an initial corpus of Rs.172.5 crore, became operational from May 12, 1997. The fund guarantees the settlement of bonafide transactions of BSE members and ensures timely completion of contract settlements.

Trends in Turnover on BSE

The annul turnover, market capitalization and BSE Sensex increased sharply by 99 per cent in 1991-92. Share markets were unprecedentedly buoyant due to the liberalization measures announced by the government to attract investments. Some important proposals announced in the Union Budget of 1992-93, such as the abolition of wealth tax on financial assets, abolition of the office of CCI, free pricing on permission for Indian Companies to raise funds abroad, and so on triggered volumes on BSE. Irregularities in the securities transactions of banks and financial institutions also added to the speculative pressure in the sotck markets. These irregularities were detected in 1992-93, when the scam broke out which led to the streamlining of stock market operations by BSE authorities, sharply reducing the turnover. In 1996-97, the turnover at BSE rose by 148 per cent. *Badla* was revived, which led to massive rise in the turnover in the specified group of shares. Moreover, the extension of trading terminals outside Mumbai in September 1997 and rapid progress in trading in demat paperless form were some of the reasons for increase in turnover witnessed from 1996-97 to 1998-99.

During 1999-2000, the BSE turnover witnessed a sharp increase of 119 per cent. The market was driven by large FII inflows, improved corporate performance, sound macro-economic fundamentals and upgrading of India's international credit ratings from stable to positive by international credit rating agencies. In 2000-01, the increase in turnover was 46 per cent. This was due to a slow-down in FII inflows, large sell-offs of new economy stocks on NASDAQ, increase in international oil prices, payment crisis at some stock exchanges and liquidity problems with some cooperative banks.

The number of listed companies rose from 2,471 in 1990-91 to 5,782 in 2001-02. The market capitalization is an indicator of the addition to the wealth of share owners. Its increase is a function of price change and supply change coming from new issues. In the first year of economic reforms, market capitalization increased by 256 per cent. It was the result of an increase in share prices due to an announcement of liberalization measures and the listing of six PSU stocks for the first time on the stock exchange. In the subsequent year, 1992-93, market capitalization decline due to irregularities in securities transactions. Share prices firmed up again in 1993-94 due to increased flow of foreign funds, increased investor interest and speculative trading.

The secondary market turned distinctly depressed thereafter, as the BSE Sensex lost as many as 1382.30 points by March 31, 1995. In 1996-97, 1998-99 and 2000-01, even though the turnover increased, the market capitalization declined. This indicated that the positive impact of wealth on consumption demand was lacking. The decline in market capitalization was a result of decline in the new economy share prices and large sell-offs in the global market, news about financial status of US-64, payment crisis at some stock exchanges and withdrawal of deferral products including badla. The secondary market turnover declined sharply both at BSE and NSE in 2001-02. Global recessionary conditions, international disturbances and domestic industrial slowdown accounted for this sharp decline. The BSE Sensex touched the 2600 mark on September 21, 2001 when terrorists attacked US cities. This 2600 mark was an-all time eight-year low, the lowest since September 8, 1993.

The price-earnings (P/E) ratio is the market price of a share divided by the earnings per share. It signifies the price being paid by the buyer of equities for each rupee of annual earnings, whether distributed as dividend or retained in the company. A company's P/E ratio is crucial for judging whether the prevailing market price of a share is reasonable. A market's P/E ratio is an important indicator of the general state of the share market of growth increases and confidence shoots up, the scrip gains. An increasing trend was observed in price earnings ratio from 1992-93 to 1994-95, but this trend inverted due to sluggish market conditions and touches a low of 12.86 in

1998-99. The average price-earning ratio increased in the two subsequent years, followed by a decline in 2001-02. A similar trend was observed in the price-book value ratio. The annualized yield based on 30 scrips included in the Sensex was the highest at 1.82 per cent in 1998-99 and declined in the subsequent years and again increased to 2.0 in 2001-02.

BSE milestones

1840-50	About half a dozen brokers converge under a banyan tree near what is now called Horniman Circle.
1860-65	In the prevailing share mania, the number of brokers rises to about 250 but in the aftermath of the price crash they are hard pressed to find a place for their regular meeting.
1874	The broking community find a place in what is now called Dalal Street to conduct their dealings in securities without hindrance and informal association of sorts comes into being.
July 9, 1875	The Native Share and Stock Broker Association was formed with the aim of “protecting the character, status and interests of native share and stock brokers,” with 3,128 members.
1921	The establishment of a clearing house for settlement of transactions.
1923	K P Shroff, later to be known as the doyen of the Indian stock market, assumes the post of honorary president of BSE, a position he retains till 1966. Together with Phiroze Jeejeebhoy, who succeeded him, Shroff steers the exchange through stormy times and plays a major role in raising BSE’s status.
1957	The government accords permanent recognition under the Securities Contracts (Regulation) Act, 1956.
1973	The construction work for a new multi-storey edifice to house BSE commences. It is named after its former president, Phiroze Jeejeebhoy. (P.J.Tower).
1986	On January 2, BSE launches the first stock index with 30 scrips and the base year of 1978-79.
1994	Serial bomb blasts in BSE but it begins to operate as usual despite damages to the premises.
1995	In March, BSE introduces the modified carry forward system (the traditional badla had been banned since March 1993). In July, all scrips are transferred to BOLT.

Now, more than 250 cities/towns are on BOLT trading.

1997 Screen based trading commences.

1999 In March, Central Depository Services, promoted by BSE, begins operations.

2000 In June, BSE becomes the first exchange in the country to introduce trading in derivatives in the form of index futures on the Bell Wether Sensex.

Source: Fortune India, July 31, 2000 p.22.

Conclusion

The oldest stock exchange of India faced rough weather when the National Stock Exchange (NES) was set up in 1994. It was opined that BSE would not be in a position to face stiff competition from this new and modern stock exchange. However, BSE revamped its operations quickly, adopted modern technology and gave competition to NSE.

BSE is still in the process of reforming itself. The involvement of BSE brokers and its elected members in a series of scams has affected its image and small and institutional investors have more or less lost faith in it. It is in the process of organizing and restructuring itself into a corporate entity.

5.3.2 THE NATIONAL STOCK EXCHANGE OF INDIA

The stock markets witnessed many institutional changes in the 1990s. One of them was the establishment of NSE, a modern stock exchange which brought with it the best global practices.

The NSE was incorporated in November 1992 with the following objectives.

(i) To establish a nationwide trading facility for equities, debt instruments, and hybrids.
(ii) To ensure all investors all over the country equal access through an appropriate communication network.
(iii) To provide a fair, efficient, and transparent securities market to investors through an electronic trading system.
(iv) To enable shorter settlement cycles and book entry settlement system.
(v) To meet the current international standards of securities markets.

The Pherwani Committee, which mooted the settling up the NSE, wanted different trading floors linked through a technologically backed automated network thereby creating an exchange with a national network. However, instead of providing a common platform to all regional stock exchanges, NSE is competing with BSE and has created a problem of survival for other exchanges.

NSE, unlike other Indian stock exchanges, is a tax-paying company incorporated under the Companies Act, 1956. It has been promoted by leading financial institutions and banks to provide automated and modern facilities for trading, clearing and settlement of securities in a transparent, fair and open manner and with countrywide access.

The exchange is professionally managed in that the ownership and management of NSE are completely separated from the right to trade on the exchange. In order to upgrade the professional standards of the market intermediaries, the exchange lays stress on factors such as capital adequacy corporate structure, track record, and educational experience.

NSE's membership is always on tap and anyone who meets the eligibility criteria such as cash deposit and high net worth can become a member. A member, who wants to quit business, can do so freely and have all deposits back after meeting all liabilities.

NSE members are connected to the exchange from their work stations to the central computer located at the exchange through a satellite using VSATs (Very Small Aperture Terminals). NSE has installed over 2,826 VSATs in over 366 cities across the country. Members can place orders from their office and extend connectivity to clients through the Computer to Computer Link (CTCL) facility outside their premises. Registered dealers of the members have remote trading terminals at their offices and they trade electronically on `NSE-NET' trading system through the CTCL server installed at the members' office. Through this facility, members can have total control over their network and they can closely monitor the orders placed by their registered dealers/branches.

NSE was granted recognition as a stock exchange in April 1993 and it started operations with the Wholesale Debt Market (WDM) segment in June 1994. It started equity trading in November 1994 and in a short span of one year, surpassed the volume at BSE, the largest stock exchange in the country, NSE is the only stock exchange in the world to get to the first place in the country in the first year of its operations.

NSE introduced, for the first time in India, fully automated screen based trading eliminating the need for physical trading floors. This screen based trading was the first to go live in the world through satellite communication.

NSE's information technology set-up is larger than that of any company in the country. It has a state-of-the-art client server application. Recently, NSE was awarded Cyber Corporate of the year for effectively deploying web technologies through its website.

NSE was the first exchange to grant permission to brokers for Internet trading. Four members were granted permission to commence Internet trading. NSE incorporated a separate entity – NSE IT Ltd., in October 1999, to service the securities industry in addition to the management of IT requirements of NSE.

Book Building at NSE

NSE developed a system of managing the primary issues through screen based automated trading system. NSE offers its nationwide network for conducting on-line IPOs through the book building process. It operates fully automated screen based bidding system called NEAT IPO that enables trading members to enter bids directly from their offices through a sophisticated telecommunication network.

National Securities Clearing Corporation Limited

In April 1995, NSE set up the National Securities Clearing Corporation Limited (NSCCL), a wholly owned subsidiary, to undertake clearing and settlement at the exchange. It commenced operations from April 1996. It operates with a well-defined settlement cycle, aggregates trades over a trading period, nets the positions to determine the liabilities of the members, and ensures movement of funds and securities to meet respective liabilities.

NSCCL assumes the counterpart risk of each member and guarantees settlement. Settlement guarantee is a guarantee provided by the clearing corporation for the settlement of all trades even if a party defaults to deliver securities or pay cash. NSCCL started the settlement guarantee fund for the capital market in June 1996 with an initial corpus of Rs.300 crore. This fund stood at Rs.1,651 crore at the end of August 2002. It cushions itself from any residual risk. Members contribute to this fund which is utilized for the successful completion of settlement. A separate Settlement Guarantee Fund (SGF) is maintained for the Futures and Options (F&O) segment. The corpus of the SGF (F&O) as on August 31, 2002, stood at Rs.819 crore.

NSCCL, in association with clearing banks, provides working capital funding to clearing members. A clearing bank has to enter into an agreement with NSCCL and the clearing member and open clearing accounts with depositories. The clearing member has to approach its bank which would extend the funding requirements in consultation with NSCCL.

NSCCL has introduced the facility of direct payment to clients account on both the depositories - NSDL and CDSL. Based on the information received from members, the NSCCL sends payout instructions to the depositories which enables the clients to receive the payout directly into their accounts on the payout day.

NSCCL also offers Constituent Subsidiary General Ledger (SGL) facilities to investors in government securities. SGL is a facility provided by the Reserve Bank of India to large banks and financial institutions to hold their investments in Government securities in the electronic book entry form. The securities held in SGL can be settled through a Delivery-versus-Payment (DVP) mechanism which ensures simultaneous movement of funds and securities.

Mutual Fund Service System (MFSS) is a facility provided by NSCCL to investors for transacting in dematerialized units of open-ended schemes of mutual funds. The objective is to provide to the investor a one-stop shop for transacting in financial products. MFSS addresses the need for a common platform for sale and repurchase of units of schemes managed by various funds. The exchange with its extensive network covering around 400 cities and towns across the country, offers a mechanism for electronic on-line reflection of orders from the market and the clearing corporation acts as a central agency for the clearing and settlement of all orders. The transactions are not covered by settlement guarantee.

The partners of NSCCL are clearing members, clearing banks, depositories, professional clearing members, and customers.

NSCCL was permitted to operate a stock lending/borrowing scheme from July 1998 NSE and NSCCL commenced Automated Lending and Borrowing Mechanism for lending and borrowing of securities from February 10, 1999. ALBM facilitated borrowing/lending of securities/funds at market-determined rates to meet mediate settlement requirements or payment obligations at a reasonable cost and low risk. The ALBM was NSE's answer to BSE's badla. ALBM was restricted to only S&P CNX Nifty and CNFX Nifty Junior Index securities. Badla was supposed to be a pure financing mechanism while ALBM was a security lending and borrowing mechanism. The trades in the LABM segment were guaranteed by the settlement fund of the NSE. This deferral product has been banned by SEBI along with other deferral products from July 2001.

Membership Pattern on NSE

The management of NSE is in the hands of professionals as distinct from the trading members to avoid any conflict of interest. Moreover, a conscious effort is made to improve membership standards to strengthen confidence in the operations of the exchange.

Indices

The NSE Fifty was rechristened as S&P CNX Nifty on July 28, 1998. This index is widely used as it reflects the state of the market sentiments for fifty highly liquid scrips.

The CNX Nifty Junior is a mid-cap index introduced in January 1997 to cater to the growth companies in the economy. The companies included are those which are traded with an impact cost of less than 2.5 per cent on 85 per cent of the trading days.

A new index called S&P CNX Defty (dollar denominated S&P CNX Nifty) was introduced on November 26, 1997. It shows returns on S&P CNX Nifty index in dollar terms. S&P CNX Defty serves as a performance indicator to foreign institutional investors, offshore funds, and others. It is also used as an effective tool for hedging Indian equity exposure. This new index is available on-line.

NSE Milestones

November 1992	Incorporation
April 1993	Recognition as a stock exchange
May 1993	Formulation of business plan

June 1994	Wholesale Debt Market segment goes live
November 1994	Capital Market (equities) segment goes live
March 1995	Establishment of Investor Grievance Cell
April 1995	Establishment of NSCCL, the first clearing corporation
June 1995	Introduction of centralized insurance cover for all trading members
July 1995	Establishment of Investor Protection Fund
October 1995	Becomes largest stock exchange in the country
April 1996	Commencement of clearing and settlement of NSCCL
April 1996	Launch of S&P CNX Nifty
June 1996	Establishment of Settlement Guarantee Fund
November 1996	Setting up of National Securities Depository Limited, first depository in India, co-promoted by NSE
December 1996	Launch of CNX Nifty Junior
May 1998	Promotion of joint venture. India Index Services and Products Limited (IISL)
May 1998	Launch of website: www.nse.co.in
July 1998	Launch of Certification Programme in Financial Market
February 1999	Launch of Automated Lending and Borrowing Mechanism
April 1999	Chip Web Award by Chip magazine
October 1999	Setting up of NSE-IT
January 2000	Launch of NSE Research Initiative
February 2000	Commencement of Internet trading
June 2000	Commencement of derivatives trading (Index Futures)
September 2000	Launch of Zero Coupon Yield Curve

December 2000	Commencement of WAP trading
June 2001	Commencement of trading in Index Options
July 2001	Commencement of trading in Options on Individual Securities
November 2001	Commencement of trading in Futures on Individual Securities
December 2001	Launch of NSE VaR for government securities
January 2002	Launch of Exchange Traded Funds (ETFs)
May 2002	NSE wins the Wharton-Infosys Business Transformation Award in the Organization-wide Transformation category

Capital Market Segment of NSE

The capital market segment, which covers trading in equities, commenced trading on November 3, 1994. NSE adopted the order-driven trading system as opposed to a quote-driven system. The order-driven system helped reduce jobbing spreads to cut down transaction costs.

As of March 2002, there were 793 listed companies on NSE. On an average, 85 per cent of their stocks are traded everyday. The exchange covers 90 per cent of all-India market capitalization.

Trading volumes increased tremendously during the years 1994-95 to 2000-01. A major reason for this growth was the nationwide reach of NSE. The superior technology of NSE enabled an investor in the remote part of the country to trade safely. The liquidity in the NSE market was not limited to high-market capitalisatijon stocks but was found in other mid and low-capitalisation stocks also. Trading volumes declined in 2001-02 but again picked up in the first quarter of 2002-03. There was a strong buying interest in mid-cap technology stocks, in PSU scrips following acceleration of the disinvestments programme and in banking scrips due to their improved performance and relaxation in FDI limits. The market capitalisatijon of listed companies depicts rising trend except in the year 2000-01 due to a decline in the market prices of IT stocks.

Conclusion

The National Stock Exchange has emerged as a technology-driven stock exchange. It has rightly positioned itself as “The Exchange with a difference”. In order to maintain its leading position among the exchanges it increases the number of users by trying to meet their growing and ever new types of needs through innovative effort. Its aim is to continuously upgrade technology systems and trading practices. The setting up of the NSE has changed the face of the Indian stock market.

5.4 OVER THE COUNTER EXCHANGE OF INDIA

OTCEI was promoted jointly by the ICICI, UTI, SBI Capital Markets Ltd., Canbank Financial Services Ltd., GIC, and LIC. It was recognised as a stock exchange under the Securities Contracts (Regulation) Act, 1956 with effect from August 23, 1989. The exchange was incorporated as a company under section 25 of the Companies Act, 1956 on September 20, 1990 with an authorized capital of Rs.10 crore and a paid-up capital of Rs.5 crore.

It is based on the model of National Association of Securities Dealers Automated Quotation (NASDAQ) of USA, with modifications to suit the Indian conditions. It commenced operations from October 6, 1992.

It was set up to provide small and medium companies an access to capital market for raising finance in a cost-effective manner and investors with a convenient, transparent, and efficient avenue for capital market investment.

OTCEI was the first ringless, electronic and national exchange with a screen-based trading system listing an entirely new set of companies of small size. It allowed companies with a paid-up capital as low as Rs.30 lakh to get listed. It brought screen-based trading system in vogue for the first time. This was quite different from the open outcry system at BSE. Moreover, each strip listed on the exchange had atleast two market makers who continuously gave two-way quotes.

At OTCEI, there are two ways of making a public offer, a direct offer and an indirect one. In direct offer, a company can offer its shares directly to the public after getting it sponsored while under an indirect offer, the company may sell the shares first to a sponsor who would offload them later.

Trading Documents on OTCEI

The trading documents on OTCEI are Counter Receipts (CRs) – permanent and temporary CRs, sale confirmation slip, application acknowledgement slip, and transfer deed.

The counter receipt contained names of the investor and the company, number of shares, name and address of the registrar, price, commission, date and time of the transaction, investor's signature, name of his bank, and signature of the issuing counter. Four copies of CR were prepared and sent to the investor's counter, OTCEI, registrar and investor. The counter receipt could be exchanged for share certificate at any of the counters of OTCEI. If the investor wanted to sell these shares on OTCEI, he had just to surrender the permanent counter receipt and transfer deed at the exchange and get a sale confirmation slip. Later, as the trading volumes dipped, counter receipts were replaced by share certificates from March 1999.

Advantages

OTCEI was the first exchange in India to have on-line trading-cum-depository. It became quote driven and a transparent system of trading. It provides a liquid cash market for retail investors with a T+3 rolling settlement system and no problem of bad or short deliveries. Despite the unique advantages of the system, OTCEI got off to a poor start. Trading volumes were thin, liquidity was poor, and most of the investors were not aware of the existence. This was the result of the absence of a nationwide network, lack of an on-line communication network of its own and the fact that in the initial stages it restricted its business to Mumbai.

Steps to improve Turnover on OTCEI

During 1993-04, OTCEI entered a Memorandum of Understanding (MOU) with the NASDAQ for enhanced cooperation between the two exchanges in the area of market technology, regulations, and business development.

As part of its expansion programme, OTCEI invited applications in January 1995 for dealership in 54 cities, in 19 states across the country, to achieve nationwide coverage. As a result, OTCEI could expand its dealer network from just 5 cities in 1995-96 to 23 cities during 1996-97. It has 60 national members and 145 dealers.

In order to increase the popularity of OTCEI, SEBI relaxed norms for listing on OTCEI during March 1995. SEBI also permitted finance and leasing companies to get listed on OTCEI. With the exposure of price rigging scams of finance companies, OTCEI modified its guidelines in April 1995, making the listing of finance companies more stringent. Companies covered under the FEMA/MRTP Act were permitted to be listed on OTCEI. Hence, medium-sized companies belonging to big industrial groups could join the OTCEI.

In 1996-97, OTCEI introduced trading of PSU bonds and launched a new segment called the listed mutual fund segment.

Despite relaxing the norms for the listing of securities, the turnover at the exchange steadily declined from 1994-95. Hence, SEBI appointed two committees-Malegam and Dave Committees-to review OTCEI's working and suggest measures to improve its functioning. The recommendations of these committees suggested relaxing the strict norms with which OTCEI had begun operating. During 1997-98, OTCEI relaunched trading in the permitted segment witnessed increased activity with a coverage of 15 cities.

OTCEI revamped its trading activity by switching from the system of Counter Receipts to share certificates and dematerialisation, with effect from March 1, 1999. Under the CR system, it was difficult to match the buyer and seller receipts which resulted in delays. All CRs in circulation were converted to share certificates or dematerialized.

OSL:OTCEI incorporated, on November 25, 1999, a wholly owned subsidiary OTCEI Securities Limited (OSL) to provide multiple benefits and greater business opportunities to its members. OSL was granted the certificate of commencement of business on January 14, 2000. When the volumes on OTCEI were plummeting and to provide its members an access to the trading segment of NSE at a considerably low cost, OSL became a member of NSE. The members and dealers of OTCEI are eligible to register themselves as sub-brokers of OSL. This has increased business opportunity for the members and reduced the brokerage charges payable by investors.

Growth Equity Market

GEM is the OTCEI's new market for new enterprises. GEM enables businesses to seek proper valuation and see their shares more widely traded without formally listing their shares on a stock exchange through the traditional listing mechanism. This provides an opportunity/exit route for investment in venture capital and private equity funds and also promotes organized trading in unlisted securities by bringing scattered investors to a common trading platform.

Conclusion

The Washington based NASDAQ, on the lines of which OTCEI was formed, is the most vibrant OTC market in the world, mainly for small, growth-oriented companies. Some of the most innovative companies in the USA like Microsoft Corporation, Intel Corporation, and Oracle Corporation are listed on the NASDAQ. More than 50 per cent of the total shares traded in the USA are through the NASDAQ where trading is carried on by dealers or market makers.

Even though OTCEI is based on the model of NASDAQ, OTCEI has been languishing right from the beginning. Inspite of the prevalence of exclusive concepts like market making, rolling settlement, depository based trading, sponsorship based listing of companies and connectivity of operations simultaneously in 42 cities, the exchange has failed to take off. The main reason that can be attributed for its poor performance is the failure to create a unique impression in the minds of investors, the majority of whom are hardly aware of its existence and its mode of operations. It is perceived as a kindergarten exchange. Low investor interest has killed it. Hence, it should either be closed or merged with other stock exchanges.

5.5 INTERCONNECTED STOCK EXCHANGE OF INDIA

The Indian stock market has undergone a sea change with the opening up of the economy and economic reforms. With competition swaying the entire market, stock exchanges have been no exception.

The national reach of BSE and NSE and cutthroat competition between them, threatened the existence of the regional stock exchanges (RSEs). The volume of business on the RSEs, which accounted for 9.2 per cent of the total turnover in 1995-96, plummeted to 3.5 per cent in 1998-99. Trading at stock exchanges in Guwahati, Magadh, Indore, Mangalore and Rajkot came to a halt even though trading at all these stock exchanges too had been automated. The survival of these RSEs, which once had a secure position, had now become a cause for concern. So these RSEs formed the Federation of Indian Stock Exchanges (FISE) in early 1996. The eroding market share, dwindling volumes, and declining profitability of members at the RSEs left the FISE with two options join hands with the BOLT expansion plan or maintain status quo and wait until the capital market revived.

It was impossible for most of the RSEs to become members of either BSE or NSE. Hence, to improve market efficiency and facilitate trading among the RSEs, FISE proposed an Inter Connected Market System (ICMS). It sought technical assistance from the US Agency for International Development – Financial Institutiuons Reforms and Expansion (USAID-FIRE) Project, administered by Price Waterhouse. With its assistance, the Interconnected Stock exchange of India (ISE) was set up as the twenty-third stock exchange in the country.

The ISE, promoted by 15 RSEs, opened a new national segment of trade to all members of the exchanges while retaining the regional segments of trading at these exchanges. The ISE was granted recognition under the Securities Contracts (Regulation) Act, 1956 by SEBI in November 1998. ISE commenced its trading operations on February 26, 1999. The 15 participating exchanges of ISE have about 4,500 members and about 3,500 securities listed on them. ISE is the stock exchange of stock exchanges, members of the participating stock exchanges being only traders on ISE.

ISE has provided a highly automated trading system open to all the registered traders of the participating exchanges with direct access to its national level trading platform on an equal footing regardless of the location of the participating exchange and of the status of the exchange in terms of turnover, financial strength and so on. It has not only a professionally qualified managing director and a fulltime director, but also a public representative as the chairman of the exchange.

ISE has a uniform trading and settlement cycle and a settlement guarantee fund. It is a centralized national level market for trading in securities, with decentralized operations as the participating regional stock exchanges continue to be centers for trading, clearing and settlement as also for redressal of grievances of investors and others.

ISE contributed a meager of Rs.545 crore in 1999-2000, Rs.233 crore during 2000-01 and Rs.55 crore in 2001-02. This stock exchange has also failed to make its presence felt in the Indian stock market.

5.6 REGIONAL STOCK EXCHANGES

One significant aspect of the Indian capital market is the existence of as many as 19 regional stock exchanges-the highest in the world. RSEs existed in developed markets also but ultimately, they had to shut down or merge with the principal exchanges. Over 20 stock exchanges existed in the U.K. until 1973. By 1965, the regional exchanges joined together to form the Federation of Stock Exchanges and amalgamated to become a fully unified stock exchange in 1973.

Australia had six exchanges which got together and established the Australia Associated Stock Exchanges (AASE), a company limited by its guarantee, to represent them at the national level. In 1987, the Australian Stock Exchange (ASX) commenced operation, with the six capital city exchanges as its wholly owned subsidiaries. In Italy, all securities listed on the Milan Stock Exchange and nine other RSEs were transferred to a national computerized order-driven trading system under the Italian Stock Exchange in 1991. Today, the Italian stock market is a computerized system which has no specific location.

In India, the area of operation and jurisdiction of the regional stock exchanges were specified. The emergence of a number of regional stock exchanges was the result of India's geographical and telecommunications limitations.

These regional stock exchanges provided investors an access to big brokers in Mumbai. They also served as a link between the local companies and local investors. Reputed local companies could get themselves listed on these exchanges and the regional stock exchanges promoted trading in these local scrips. This led to a competition among issuers and they listed their securities on as many exchanges as possible to attract investors from all over the country. Moreover, each regional stock exchange followed its own practice and procedures in respect of listing and trading of securities, clearing and settlement of transactions, and risk containment measures. This resulted in a waste of the resources of the issuers for complying with the listing requirement of a number of exchanges simultaneously. Again, competition amongst exchanges increased to attract as many issuers as possible. The listing fees constitutes a major source of income and to maintain these fees, listing standards were diluted. The regional stock exchanges did well till the beginning of the 1990s.

In the 1990s, new stock exchanges – Over the Counter Exchange of India, National Stock Exchange and Inter-Connected Stock Exchange of India – were set up and permitted nationwide trading. Subsequently, all stock exchanges were permitted to expand across the nation. Inspite of this expansion, the turnover did not increase because with the spread of on-line trading, traders in remote parts of the country could deal directly with NSE or BSE. Hence, there was no need to go through regional exchanges. Besides this, the members of these regional stock exchanges involved themselves in speculation instead of reaching out to new investors and catering to local companies in an efficient manner. With turnover plunging, most RSEs acquired membership of BSE or NSE and became their stockbrokers.

Many large companies decided to delist on all stock exchanges except BSE and NSE. Since listing fees constitutes the major source of income, the question of viability of these stock exchanges arose. Apart from listing fees, another source of income for stock exchanges is interest and rent. These stock exchanges receive custodial deposits for risk management and earn interest on them. Despite increase in the interest income, most of the stock exchanges have incurred losses.

The share of the regional stock exchanges in the total turnover plunged in 2001-02. The daily turnover at the Delhi Stock Exchange plunged to Rs. 100 crore in 2002. Stock Exchanges such as Guwahati, Cochin, Jaipur, Bhubaneshwar, Mangalore, Madhya Pradesh and Magadh, have an almost negligible turnover. There is insignificant or no trading at all in these stock exchanges. The percentage of turnover on regional stock exchanges was around 3.8 per cent in 2001-02.

In 2001-02, NSE commanded around 80 per cent of the turnover while BSE accounted for 16 per cent. The regional stock exchanges together accounted for the remaining 4 per cent of the total turnover. Regional stock exchanges were needed when there was no electronic trading. With

NSE and BSE offering nationwide screen based trading, the question has arisen whether regional stock exchanges are needed at all.

Investors prefer NSE as revealed by the statistics on the National Stock Exchange. In December 2001, as much as 61 per cent of NSE's total cash market turnover originated from cities other than Mumbai, compared to an average of 51 per cent in 2000-01. This is mainly due to a rise in contributions from centers such as Bangalore, Delhi, Visakhapatnam, Kanpur, and Ludhiana. The share of smaller towns increased throughout the financial year 2001-02.

Looking to this scenario, it seems that in the long run, there will be only two stock exchanges in India: National Stock Exchange and Bombay Stock Exchange. The lead that the National Stock Exchange has gained over BSE will increase in the coming years as NSE is perceived to be more investor-friendly than BSE by most investors. The regional stock exchanges will be forced to down their shutters as low turnover volumes will result in huge revenue deficits. Moreover, most of the stock exchanges do not have the money to upgrade their IT infrastructure, a prerequisite to survive and compete in the future.

MEASURES TO BOOST LIQUIDITY IN THE SECONDARY MARKET

A number of measures were taken by SEBI to increase liquidity in the stock market. The stock market was opened to foreign institutional investors (FII) for investment. The depository system, stock lending system, buy back of shares, market making system, margin trading of shares and rolling settlement were introduced to increase liquidity in the stock market.

5.7 SUMMARY

The Indian Stock Market has a history of more than 125 years. It has undergone a number of changes during this period. New trading systems, new stock exchanges, new players, new instruments and new markets have come into existence. Today, Bombay Stock Exchange and National Stock Exchange are the most technically developed in the world. These are on par with stock exchanges of developed countries. The introduction of online system, rolling settlement have facilitated quick trading and settlements, which lead to larger volumes. Today, National Stock Exchange of India Limited has revolutioned the face of stock exchanges and markets. NSE is the market leader and the 131-years old BSE is lagging behind. NSE, in a very short span of time took the leading position. It is perceived as investor-friendly. BSE and other regional stock exchanges are surrounded by controversies relating to price manipulation, insider trading, circular trading and so on which have eroded investor's confidence and wealth. Regional Stock Exchanges are on the verge of closure and are planning to merge either with BSE or NSE. In future, only two stock exchanges will survive - NSE and BSE. Because of Globalisation, these exchanges will have to face stiff competition internationally. They have to gear up themselves to face global competition. These have to plan strategic tie-ups with their foreign counterparts to get an international platform.

5.8 KEYWORDS

1. Carry forward / Badala: Provide the facility for carrying forward the transactions from one settlement to another settlement.

2. Stock Market Index: It is barometer of market behaviour and it reflects market directions. It is also an indicator of day-to-day fluctuations in stock prices.

5.9 SELF-ASSESSMENT QUESTIONS

1. Describe the evolution process of Bombay Stock Exchange.
2. Explain the history of incorporation of National Stock Exchange of India Ltd., and state the objectives of NSE.
3. Critically evaluate the role of National Securities Clearing Corporation of India Ltd.
4. Describe the role of Over The Counter Exchange of India. How it is different from the other exchanges.

5.10 FURTHER READINGS

1. Indian Financial System by Bharati V.Pathak.
2. Financial Institutions and Markets by L.M.Bhole.

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