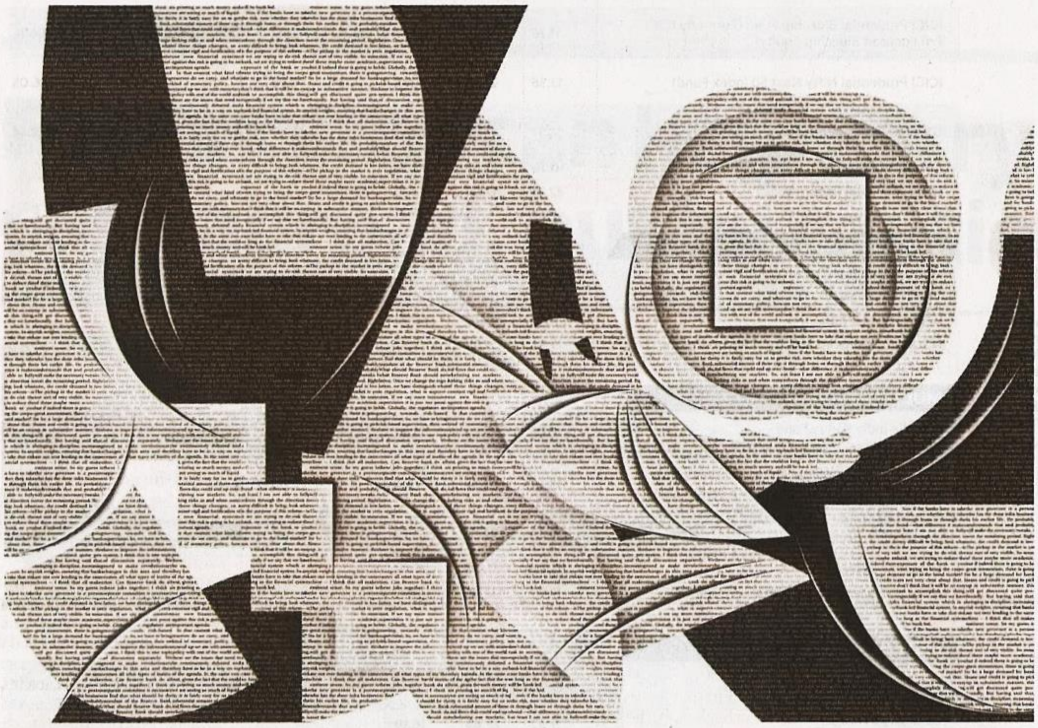
Headline: The road ahead for the National Stock Exchange	
Source: Mint	**Date:** 2 August 2018

The road ahead for the National Stock Exchange

The story of Indian capital market development over the past 25 years has been inextricably linked to the NSE story



JAYACHANDRAN/MINT

The National Stock Exchange (NSE) opened for business at a time when the Indian capital markets had just been hit by the Harshad Mehta scam, the existing exchanges were in the iron grip of broker cartels and archaic settlement systems were prone to frequent crises. The new exchange was set up in the teeth of formidable opposition. Its combination of technology, risk management and governance was way ahead of its time. The NSE was part of a quartet of institutions that totally changed the Indian capital markets game; the other three were the Securities and Exchange Board of India, National Securities and Depositories, and the Clearing Corporation of India. The four organizations were led by visionary leaders such as R.H. Patil, G.V. Ramakrishna and C.B. Bhave, who epitomized the idea of institution builders. India owes them a lot.

The NSE enters its 25th year of operations later this month. Its success is undeniable, though there have been blemishes along the way. For example, the Competition Commission of India said that the NSE had used its dominance to indulge in predatory pricing in the currency derivatives segment. The markets regulator investigated claims that the exchange had given select brokers preferential access to information, in what is known as the co-location case. There have been heated debates about the governance standards at the exchange, as the former challenger became the dominant player.

Some of the problems arise from the fact that the NSE, on one hand, is a company owned by investors, and on the other, it operates as a public institution. There is an inherent tension in this arrangement. Yet, despite some of the more recent controversies, the NSE has undoubtedly helped transform Indian capital markets over the past 25 years. The agonies of fortnightly settlements, onerous exchanges of physical shares, payment gridlocks and trading glitches are only dim memories today.

What is the road ahead? The new management at the NSE has an important task since the organization has a central role to play in capital allocation in a \$2.8 trillion economy. There are several tasks ahead.

First, there is a need to further develop the market for risk capital, both equity and debt. The latter is perhaps a more urgent problem given the fact that the banking system is in a mess. The NSE will have to help develop deeper bond markets as larger companies become more dependent on corporate bonds, while getting more retail investors to buy government bonds will help reduce financial repression.

Second, more active bond markets will necessarily require ways for investors to hedge their credit and interest rate risks through derivatives. The two go together.

Third, the NSE will have to play an important role in the integration of Indian capital markets with global capital markets. The balance sheets of Indian companies now have a more global flavour even as capital controls persist, as they must in a country with high fiscal deficits, a weak banking system and episodes of high inflation. So, the integration has to be carefully managed.

Fourth, the NSE built its initial success based on its technology platform. It remains to be seen how it adapts to the next wave of technology such as blockchain. The exchange is already experimenting with the possibility of using blockchain for settlements.

Fifth, more enterprises need to come to the bond markets to raise capital. The current conservative regulations restrict access to only those which have a credit rating of AA and above.

The exchange is doing its bit with new initiatives such as encouraging a repo market in corporate bonds, allowing retail investors to get access to government bonds on a non-competitive basis in the Friday auctions, trying to onshore global products based on the Nifty index, developing a bond exchange traded fund, etc. Needless to say, none of this can be done without the active support of various regulators. The original idea of setting up the NSE was part of a broader game plan for financial sector reforms. The same principle applies to the current situation as well.

The story of Indian capital market development over the past 25 years has been inextricably linked to the NSE story. It will be so for the next 25 years as well.

What can the NSE do to deepen the Indian capital markets? Tell us at views@livemint.com