# 4 Secondary Market

Of the 23 stock exchanges in the country as on 31st March 1999, 20 are regional ones with allocated areas while three others set up in the reforms era, viz. the National Stock Exchange of India Ltd. (NSE), the Over The Counter Exchange of India (OTC) and the Inter Connected Stock Exchange of India (ICSE) have been mandated to have nation-wide trading. Some of the regional stock exchanges have also been allowed to have nation wide network. A security is listed on any one or more of the stock exchanges in addition to listing on the regional exchange, which is compulsory. A security listed on an exchange can be permitted for trading by another exchange. Every stock exchange follows its own trading practices and procedures in respect of (a) settlement of transactions (b) payment and delivery dates (c) closure of books (d) marketing of securities (e) control over kerb-activity (e) trading hours etc. although these are being gradually standardised. The fragmentation of markets, particularly when the floating stock is not large, leads to a situation where the same security may be quoted at widely different prices at the same time. The structure of the secondary market as on 31st March 1999 is presented below :

| | |
|---|---|
| No. of Stock Exchanges | 23 |
| No. of Exchanges with Screen Based Trading System | 23 |
| No. of Exchanges with Clearing House | 22 |
| No. of Exchanges with Clearing Corporation | 1 |
| No. of Registered Members (brokers) | 9069 |
| No. of Registered Corporate Members | 3173 |
| No. of Registered Sub-Brokers | 4589 |
| No. of Registered Foreign Brokers | 32 |
| No. of Registered FIIs | 450 |
| No. of Listed Companies | 9, 877 |
| Market Capitalisation | Rs.5,74,064 crore |
| Turnover during 1998-99 | Rs.1,023,382 crore |

## SCREEN BASED TRADING SYSTEM (SBTS)

Emergence of NSE, which uses world class technology and trading, clearing and settlement system, is perhaps the most important event in the securities market reforms. NSE was set up with the objectives of (a) providing a nation wide trading facility for all types of securities, (b) ensuring equal access to investors all over the country through a communication network, (c) providing a fair, efficient and transparent securities market using an electronic trading system and (d) enabling the use of shorter settlement cycles and a book entry settlement system. The NSE provides a fully automated order driven SBTS in debt and equity instruments. Within a brief period, the NSE displaced the century-old BSE to second position in terms of turnover in 95-96. All regional stock exchanges also lost business to the NSE and are in the danger of going out of business. To counter the threat of the NSE, the Stock Exchange, Mumbai substantially improved its trading systems and infrastructure - it introduced a modern electronic trading system called BOLT, or the Stock Exchange, Mumbai On-line Trading System and tried to reach other parts of the country. This has been followed by other regional stock exchanges.

Trading on stock exchanges used to take place through open outcry without use of information technology for immediate matching or recording of trades. This was time consuming and inefficient. The practice of physical trading imposed limits on trading volumes and hence the slow speed with which new information was incorporated into prices. The emergence of the National Stock Exchange revolutionised trading of securities in India. It introduced SBTS where a member can punch into the computer quantities of shares and the prices at which he wants to transact. The transaction is executed as soon as the quote punched by the member finds a matching sale or buy quote from a counter party. SBTS electronically matches the buy and sell orders in an order-driven system or finds the customer the best price available almost instanteneously, and hence cuts down on time, cost and risk of error in order execution. SBTS enables distant participants to trade with each other, improving the liquidity of the markets, and the high speed with which trades are executed and the large number of participants who can trade simultaneously allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. With SBTS, it becomes possible for market participants to see the full market, which helps to make the market more transparent, leading to increased investor confidence. NSE and OTC started nation wide SBTS, which provided completely transparent trading mechanism. Regional exchanges lost a lot of business to NSE, forcing them also to go for SBTS. Today India boasts of 100 percent trading through electronic order matching.

## MANAGEMENT OF STOCK EXCHANGES

Amongst the many new concepts introduced by NSE in the securities market, the most crucial one relates to the governance of the Exchange. Historically the trading members who provided broking services also owned, controlled and managed the stock exchanges. This model was designed to serve traditional exchanges, which were essentially regional in character. This model, apart from facing a severe handicap of a perceived conflict of interests is considered unsuitable for electronic exchanges which have trading members spread all over the country. NSE represents a paradigm shift in that for the first time in the country, the ownership and management of the exchange have been divorced from trading rights. NSE is owned by a set of important financial institutions and banks of the country and is managed by professionals who do not directly or indirectly trade on the exchange.

It is important to note that the NSE model does not preclude but accommodates members' involvement, support and contribution in a variety of ways. In fact a large part of the success of NSE has been the active and strong support of its members. This has taken place through several key committees as also through formal and informal member interactions. NSE continues to emphasise relationship building with all its participants, including trading members, investor community and the issuers, whose securities are traded on the Exchange.

There appears to be some relation between trading technology and exchange ownership. Member-owned entities seem to work for no-profit and, therefore, prefer open outcry trading which utilises their skill, while electronic trading is preferred by for-profit entities. This relationship has been well evidenced by S. Craig Pirrong, in his article "Exchange Governance under the Electronic Paradigm" (Catalyst Institute Update, Third Quarter 1999) as reproduced in the Box No.1.

*Box No 1:* **Exchange Governance under the Electronic Paradigm**

The shift to electronics trading is reshaping the financial environment in many ways. One of the most interesting is the linkage between electronic trading and exchange ownership. Some electronic exchanges are for-profit institutions, some are publicly traded, and some-including some that intend to shift from open outcry to electronic trading-are planning to shift from member-owned to for-profit. In contrast, traditional open outcry exchanges are almost exclusively organised as not-for-profit, member-owned entities.

**The Ownership Link**

The apparent linkage between trading technology and ownership structure is not accidental. It makes sense for an open outcry exchange to be owned by intermediaries -local traders and floor brokers. Their presence is necessary for an open outcry market to operate efficiently. They have the incentive to control the exchange to ensure that its rules and policies maximize the value of their specialised skills. The mutual form of exchange ownership assures this. Moreover, academic research has demonstrated that non-profit organisation is efficient for an open outcry exchange to allay disputes that can arise because of a diverse membership.

In contrast, an electronic exchange is essentially a communications system that links individuals and firms dispersed among many locations. It shares strong similarities to a telephone system. Just as there is no compelling economic reason for individual phone users to own and control the phone system, there is no compelling economic reason for an electronic futures exchange to be owned by its users. Ownership and use can be separated. Once ownership and use are separated, the rationale for the non-profit form of organisation disappears. That is because there is less potential for dispute among owners of an electronic exchange than among the intermediaries (the floor brokers, the locals, and the brokerage firms) who own an open outcry exchange.

**The Liquidity Supply**

A shift in the type of ownership and organisation may have important implications for liquidity. Liquidity is in large part determined by exchange rules and policies. Member-owned open outcry exchanges may have incentives to make choices that differ from those made by for-profit, publicly-owned electronic markets; the liquidity of open outcry and electronic exchanges may differ as a result.

Traditional open outcry exchanges ration liquidity by limiting the number of members. There is no free entry into the profession of local trader on the floor of an exchange; the number of locals is limited by the number of exchange memberships. The restriction on entry limits the supply of liquidity and tends to reduce market depth. This benefits exchange members, but raises execution cost for those investors who demand liquidity. Indeed, member-owned, open-outcry exchanges may have little incentive to adopt rules that reduce member profits in order to enhance liquidity.

In contrast to open outcry exchanges, electronic exchanges may ration liquidity by price in order to maximize profit. A for-profit electronic exchange will probably charge prices to use the system that exceed marginal access cost. This may reduce liquidity to below the “optimal” level that would be supplied in an electronic exchange charging marginal cost prices. However, since enhancing system liquidity may cause hedgers and speculators to increase trading, electronic exchanges are likely to charge those that supply liquidity a lower price of access than those who consume it (the hedgers and speculators).

**Volumes versus Profit**

Interpreting liquidity as a choice variable for exchanges has implications for the comparative liquidity of open outcry and electronic exchanges. Specifically, incentives of open-outcry and electronic exchanges to ration liquidity may be quite different due to differences in ownership structure. Local traders and floor brokers, who typically have a major influence on the decision making of the exchanges which they own and on which they trade, profit in large part by the information advantage their presence on the floor provides. They have little incentive to support initiatives that reduce the importance of this advantage even if these changes increase exchange volume. They also have little incentive to admit new members in order to enhance liquidity.

Owners of for-profit electronic exchanges, on the other hand, will not expect to profit from trading on their own account. Instead, they will be strongly motivated to enhance volume because their profits derive from fees on transactions. Therefore, the owner of any electronic exchange may have a very strong incentive to devise a pricing structure and rules that favor liquidity suppliers. That is because the resulting decline in execution costs could lead to substantial increase in trading volume (and thus fees) from investors, speculators, and hedgers.

In sum, the electronic trading market-place will look much different than the face-to-face floor trading environment that have evolved over the last 150 years. Exchanges will be organised differently. They will also face different incentives and make different choices concerning rules and policies. These differences, in turn, will have implications for liquidity and depth. This means that the effects of the ongoing technological and structural shift in trading paradigms cannot be gauged simply by comparing the technical merits of open outcry and electronic trading. The ramifications of the shift to electronic exchanges will also depend on how this change affects the way in which exchanges are organised and governed.

These changes will also present regulators with daunting challenges. They will have to make decisions in a legal and legislative framework that developed in a different era, one that bears little relationship to what the financial landscape will look like in the future. Whether or not electronic trading achieves its full potential will depend in large part on how regulators and legislators respond to these challenges.

## POLICIES AND PROGRAMMES

Government and market regulators have been taking measures to improve the working of stock exchanges and market intermediaries, who together provide a platform for trading of securities, so as protect the integrity of the market and interest of investors. Many of the measures, that have a bearing on the working of the secondary market have been explained in other chapters. For example, several developments took place over last two years leading to passage of the Securities Laws (Amendment) Act, 1999 which paves way for trading of derivatives of securities. The details regarding this have been discussed in Chapter No. 8. Similarly developments in respect of dematerialisation of securities have been discussed in Chapter No. 6. A number of prudential measures have been taken to strengthen integrity of the market. These are discussed in Chapter No. 1. The following paragraphs, however, discuss policy and regulatory initiatives having a bearing on trading of securities only.

The measures initiated during **1998-99** include :

### *I. Listing and Delisting*

Following recommendations of Chandratre Committee, SEBI streamlined the procedure for listing and delisting of securities in the following manner:

(A) The stock exchanges were advised by SEBI to amend the listing agreement to provide for (a) they can collect 3 years listing fee upfront at the time of initial listing and subsequently once in three years, and (b) basic norms for listing shall be uniform for all exchanges who may specify additional norms over and above minimum norms,

(B) Companies can voluntarily delist securities from non-regional exchanges. This would require specific prior approval of the holders of the securities by a special resolution passed at a general meeting after giving due notices thereof in the manner provided in the Companies Act and an opportunity to exit. The security will still remain listed on the regional stock exchange. In case of compulsory delisting, the decision is to be taken by a panel constituted by the Exchange comprising representative of the investors, Department of Company Affairs, SEBI and officials of the Exchange.

### *II. Corporate Governance*

SEBI set up a Committee under the chairmanship of Shri Kumar Mangalam Birla, Member, SEBI Board to suggest changes in the listing agreement to promote Corporate Governance. The terms of reference of the Committee are:

(a) To suggest suitable amendments to the listing agreement executed by the stock exchanges with the companies and other measures to improve standards of corporate governance of listed companies, in areas such as continuous disclosure of material information relating to both financial and non-financial matters, accounting information, manner and frequency of such disclosure, responsibilities of independent and outside directors;

(b) To draft a code of corporate best practices; and

(c) To suggest safeguards to be instituted within companies to deal with insider information and insider trading.

### *III. Continuing Disclosure*

Quarterly disclosure of financial results to stock exchanges and public was made mandatory for listed companies through amendment of the listing agreement. The agreement was also amended to provide for details of deployment of funds mobilised on a half-yearly basis instead of yearly basis. Any material event having a bearing on the performance/operation of the company is also required to be disclosed to public immediately.

### *IV. Measures to Improve Market Microstructure*

The market practices such as hand delivery bargains, negotiated trades without price bands, 'all or none' or 'minimum fill' order facility have developed primarily to overcome the difficulties confronted in a paper based system. The present market conditions and the changes likely in the future call for elimination or modification in some of these practices, which affect the market microstructure and volatility. With a view to further improve the market microstructure and provide for increased transparency, efficient price discovery and to curb unhealthy market practices so as to enhance the confidence of the investors, SEBI took the following decisions :

(a) No Exchange shall allow the 'All or None' or 'Minimum Fill' order facility in their trading system.

(b) Stock Exchanges were directed to ensure that all negotiated deals result in delivery and deals of a value of Rs. 25 lakh or volume of 10,000 shares are reported on the screens within 15 minutes of transaction and disseminated to the market.

(c) The Price Band applicable to the Normal Trades will become applicable to the Negotiated Trades (including Cross Deals, Bulk Deals and all trades where the price is not determined on the Exchange's trading system).

(d) Delivery and payment for all "hand delivery" trades (including Trade for Trade, Negotiated Trades, Cross Deals, Bulk Deals, etc.) must be completed within the time or on the date stipulated when entering into the deal which time shall not be more than seven days following the date of the contract.

### *V. Modified Carry Forward System*

BSE was providing the facility of carry forward of trades under modified carry forward system. During 1998-99, the stock exchanges at Delhi, Ludhiana and Kolkotta were also permitted to provide this facility.

### *VI. Takeover*

Takeover Regulations were amended to increase threshold limit for mandatory public offer from 10% to 15% of the voting rights of a company. The creeping acquisition limit was also raised from 2% to 5% of the voting rights and also made applicable to persons holding above 51% of voting rights upto 75%.

### *VII. Change in name*

A few companies changed their names to new ones suggestive of lucrative business like software. In order to prevent investors from falling prey to such allurement, listing agreement of the exchanges was amended so that companies who have changed their names to denote a new activity would have to disclose in their financial statements the income of the company from such activity for a period of three years from the date of change of name.

### *VIII. Inter Connected Stock Exchange of India Limited (ICSEIL)*

ICSEIL was granted recognition as a stock exchange on November 18, 1998 as the 23rd exchange in India. It has been promoted by 14 regional exchanges. ICSEIL has set up an inter-connected market system and provides its trading members a facility to trade on the national market in addition to the trading facility at the regional exchange.

### *IX. Penalty for non-payment of SEBI Fees*

SEBI (Stock Brokers and Sub-brokers) Regulations was amended on December 16, 1998 to provide that a stock broker, who fails to remit fees in accordance with the third schedule of the Regulations, shall be liable to pay interest at the rate of 15% per annum for each month of delay or part thereof. This would be in addition to any other action SEBI may take as deemed fit against the broker/sub-broker.

### *X. Investor Education and Protection Fund*

The Companies Act, 1956 was amended to enable Central Government to establish "Investor Education and Protection Fund" from the amounts lying unpaid in the dividend account, refund due after allotment, matured deposit and debentures, interest accrued on these amounts and grants and donations by Government. These amounts should remain unclaimed and unpaid for 7 years from the date they become due for payment. The fund shall be utilised for promotion of investors' awareness and protection of interest of investors in accordance with the Rules. In pursuance to this amendment, Government has constituted a Committee on 11th November 1999 to administer the fund.

### *XI. Buy Back Of Securities*

In order to impart liquidity to securities and to enable companies to enhance wealth of the shareholders, the Companies Act, 1956 was amended to allow the Companies to buy back their own shares for capital restructuring subject to the condition that (a) the buy back does not exceed 25% of the paid up capital and free reserves of the company concerned, (b) the ratio of debt owed by the company to the paid up capital and free reserves after buy back does not exceed two, (c) the buy back is financed from free reserves, securities premium account or proceeds of any previous issue of securities of a different kind, (e) the securities bought back is fully paid up, (f) the securities bought back are destroyed within 7 days of completion of buy back, (g) there shall not be an issue of same kind of securities within a period of 24 months, and (i) the buy back of listed securities is in accordance with the SEBI Regulations. In pursuance to this, SEBI notified regulations relating to buy-back of listed securities. The salient features of the Regulations are:

(a) The buy back is permitted through the tender offer mode for buy back from the existing shareholders on proportionate basis and from odd lot holders. Similarly, the book building mode which is a modified version of the internationally practised Dutch Auction and purchases through stock exchange is permitted for open market transactions. Buy back through negotiated deals, spot transactions or private arrangements is not permitted.

(b) In the purchases made through the stock exchange, the details of purchases made in the buy back scheme of the company shall be made available to the stock exchange on daily basis which in turn shall make this information available to public regularly.

(c) The Regulations provide for extensive disclosures in the Explanatory Statement to be annexed for the notice for the general meeting and the Letter of Offer. It also provides for disclosure of the pre and post buy back holdings of the promoters.

(d) Promoters are not permitted to participate in the buy back through the stock exchange mode.

(e) In order to ensure strict compliance with the provisions of the Regulations, merchant banker has be associated in every offer for buy back wherein he would be required to give a 'due diligence' certificate.

(f) With a view to ensure completion of the buy back process speedily, the Regulations provide for time bound steps in every mode. For example, except in the cases of purchases through stock exchanges, an offer for buy back shall not remain open for more than 30 days. The verification of shares received in buy back has to be completed within 15 days of the closure of the offer. The payments for accepted securities has to be made within 7 days of the completion of verification and the shares have to be extinguished and physically destroyed within 7 days of the date of payment. The extinguishment certificate is required to be filed within 7 days of the physical destruction of the certificates.

(g) To ensure security for performance of its obligation, the company making an offer for buy back shall have to open an escrow account on the same lines as provided in the Take Over Regulations.

*Measures initiated during **1999-2000** include:*

### *I. Units of collective investment scheme (CIS)*

The Securities Laws (Amendment) Act, 1999 has expanded the definition of "securities" in the SCRA to include units or any other instruments issued by CIS to investors in such schemes. This is aimed at an orderly development of market for these units while protecting the interests of investors therein. This Act empowers central government to make rules to provide for the requirements, which shall be complied with by CIS for the purpose of getting their units listed on any stock exchange.

### *II. Appeal against refusal of Stock Exchanges to list Securities of Public Companies*

The SC (R) A provided for right of appeal before the Central government against refusal, omission or failure by a stock exchange to list securities of any public company within fifteen days of such refusal, omission or failure. Since the powers of the Central Government to issue directions and to make rules under the SC (R) A, and to appoint members on the governing bodies of stock exchanges was perceived as compromising its appellate powers, the Securities laws (Second Amendment) Act, 1999 has transferred these appellate functions from Central Government to the Securities Appellate Tribunal. Henceforth, all appeals against decision of stock exchanges on listing of a security would be preferred before the Securities Appellate Tribunal. An obligation has also been cast on the Tribunal to endeavour to dispose of the appeals finally within six months.

### *III. Relaxation of Rule 19(2)(b) of the SC(R) Rules, 1957*

In exercise of its powers under Rule 19 (7) of the SC(R) Rules, SEBI has decided to relax the requirement of offering 25% of the securities for the purpose of listing under Rule 19(2)(b) of the Securities Contracts (Regulation) Rules, 1957 for companies in the Information Technology sector subject to the following:

a. at least 10% of securities issued by the company are offered to the public,

b. at least twenty lakh securities are offered to the public (excluding reservation, firm allotment and promoters' contribution); and

c. the size of the net offer to the public (i.e. the offer price multiplied by the number of securities offered to the public which exclude reservation, firm allotment and promoters' contribution) is at least Rs. 50 crore.

### IV. *Restriction on Hand Delivery Trade*

SEBI decided that effective from January 15, 2000, all orders executed on behalf of FIIs and mutual funds must necessarily be settled directly by custodians through clearing house /clearing corporations. This decision would be applicable in respect of transactions done in all securities in which settlement of trade is compulsorily required to be settled in dematerialised form by all investors. However, in a meeting taken by SEBI on December 10, 1999 to review its decision regarding the restriction on 'Hand Delivery' trades for Foreign Institutional Investors and Mutual Funds, it was decided that

1. The hand delivery trades may be continued beyond January 15, 2000.
2. The hand delivery trades would be subjected to the same restrictions and time frame as for the transactions settled through the clearing house mechanism. These trades would also be subject to the Rules, Bye-laws and Regulations of the exchange where the transactions have been executed. In order to bring these transactions under similar time schedule as the transactions settling through Clearing House, all hand delivery trades will have to be compulsorily settled with the clients' custodians within two working days of the pay-out date for that settlement at that stock exchange. However, if the transaction is partly settled in the Clearing House and therefore involves auction / close -out procedures, then such transactions should be settled with the clients' custodians within two working days of the completion of the auction / close-out process for that settlement at the respective stock exchange.
3. The status of these trades would be reviewed in the first week of April, 2000.

### V. *Negotiated Deals*

Deals done as negotiated deals militate against the basic concept of stock exchanges which are meant to bring together a large number of buyers and sellers in an open manner. So all negotiated deals will be permitted only if these are executed on the screens of exchanges following the price and order matching mechanism of the exchanges just like any other trade. All negotiated deals in listed corporate debt securities will have to be executed on the basis of price and order matching mechanism of the stock exchanges as in the case of equities.

### VI. *Trading of Unlisted Securities*

SEBI examined OTCEI's proposal to provide a trading mechanism and price discovery for securities of public limited companies which are not listed or traded as permitted securities in any exchange. Only qualified participants (QPs) such as corporates/companies, banks and individuals with a net worth of Rs. 2.5 crore, will be allowed to trade on the market. The scrips and the QPs will be selected by the exchange. The exchange will not guarantee the settlement of trade. The securities of the companies will be listed with suitable exemptions for which regulatory changes will be made. The above system will provide a transparent trading platform and exit opportunity for small capital companies, venture capital and private equity funds

### VII. *Small Exchanges*

SEBI organised a meeting of the representatives of BSE, NSE, CSE and some of the small stock exchanges on September 8, 1999 to discuss the suggestions/revival plans forwarded by the small

Exchanges for their revival. The group made following recommendations for revival of the small stock exchanges :

A stock exchange may be permitted to promote a subsidiary which can acquire membership rights of a larger stock exchange viz. NSE/BSE/CSE/DSE or any other exchange subject to usual conditions applicable to the other members. The subsidiary will be a member of a larger exchange and the members of the small stock exchange will be registering themselves as sub-brokers of the subsidiary. It was also suggested that the subsidiary would have the entire settlement responsibility for the trades executed as a member of the larger stock exchanges on behalf of the members of the small stock exchange who would be the sub-broker of the subsidiary. The subsidiary in turn will collect margins from the sub-brokers and also enforce individual exposure/trading limits on them.

The other option is that the small stock exchanges may also sign a Memorandum of Understanding (MOU) with BSE and other exchange (with NSE there is no provision of MOU) and take necessary consequential steps for making trading arrangements. The BSE also agreed that if infrastructure of small stock exchanges is used, then revenue will be shared with the concerned exchange.

In a meeting of all the stock exchanges taken by SEBI on December 20, 1999 to discuss the issues related to survival of small stock exchanges, it was agreed that the deposit to be collected from the sub brokers of the subsidiary promoted by the Stock Exchanges would be in the form 25% cash and 75 irrevocable bank guarantee. All the exchanges shall have freedom to increase the membership or dealership subject to compliance of all the legal requirements, without the approval of SEBI. In order to utilise the existing infrastructural facilities of the regional stock exchange by the bigger exchanges, the BSE would be discussing the issue with the small stock exchanges and submit a report to SEBI by January 10, 2000. A small group comprising of representatives of small exchanges, SEBI and Forward Markets Commission will be formed to explore possibilities of utilising the infrastructure facilities of the regional stock exchange for the purpose of futures trading in commodities.

### *VIII. Expansion of Stock Exchanges*

Earlier a regional stock exchange needed to sign a memorandum of understanding (MoU) with the local stock exchange in whose area it wanted to open a trading terminal. For example, BSE needed to sign a MoU with Hyderabad stock exchange, if the former wanted to set a trading terminal in Hyderabad. SEBI did away this MoU and made all exchanges free to set up terminals anywhere in the country.

### *IX. Capital Stock Exchange, Trivandrum*

A new exchange at Trivandrum called the Capital Stock Exchange was granted recognition by SEBI. It is the 24th Stock Exchange in the country.

### *X. Year 2000 Compliance*

A time bound schedule for implementation of a comprehensive plan to combat the Y2K problem was drawn up by SEBI and was circulated to all the intermediaries functioning in the securities market. The intermediaries were advised to reach Y2K compliant position by December 31, 1998 so that they would be able to test, validate and implement the systems by June 30, 1999. The following measures were taken by SEBI to ensure Y2K compliance in the securities market:

(a) It was made mandatory for the listed companies to give a brief status on their Y2K preparedness level in their published quarterly results.

(b) It was made compulsory for all the companies, accessing securities market in 1999, to declare their Y2K preparedness status in their prospectus.

(c) In their quarterly results the companies were asked to disclose the following:-

a) the risk of the company's Year 2000 issues

b) the cost to address the company's Year 2000 issues

c) the company's contingency plans

The company's disclosure should be specific and quantified to the extent practicable.

(d) Every intermediary registered with SEBI was under an obligation to discuss the issue at the Board meeting and keep the higher management informed regarding the preparatory status for ensuring Y2K compliance.

(e) It was made mandatory for all intermediaries registered with SEBI to keep hard copies of all the current records pertaining to their own and their client's operations as on December 30, 1999.

(f) Stock Exchanges were advised to draw up necessary contingency plans in case of system disruptions due to Year 2000 problem. Stock Exchanges were also asked to disable the terminals of non-compliant brokers on November 30, 1999.

(g) Registrars and Share Transfer Agents were informed that in case of non-compliance by September 30 1999, their clients would be informed of their non-compliance status and asked to change the agency.

(h) A separate Y2K icon was created on the SEBI web-site disclosing the names of non-compliant intermediaries.

## *XI. Market Making*

SEBI had constituted a Committee on March 24, 1998 under the chairmanship of Shri G P Gupta, then Chairman, UTI and current Chairman and Managing Director of IDBI, with a view to study the concept of "Market Making" and to draft operational procedures for market making, eligibility criteria for market makers, risk containment measures, etc. The Committee submitted its final report on October 4, 1999. SEBI approved the recommendations of the committee in its meeting on 8$^{th}$ October 1999.

The committee observed that the introduction of electronic trading and "order matching" system in all the 23 stock exchanges have led to reduction in transaction costs, speedier execution of trades and gains in liquidity. The spreads have dropped by a factor of 10 and volumes have risen by a hundred fold in respect of many shares. Increase in trading volume on the exchanges, however, has not been reflected always in the liquidity of all the listed shares. There are still a large number of shares that are not actively or frequently traded although many of them have some fundamental strength and intrinsic value. The introduction of market making facility for such shares could be a possible means to infuse liquidity in such shares.

As the market makers in most markets operate under an obligation to offer continuous two way quotes, (except under certain circumstances), they are required to carry an inventory of stocks, which implies commitment of capital and exposure to market risks. An intermediary will naturally seek adequate compensation should it choose to act as market maker for a share. The Committee felt that this aspect needs to be kept in view, while working out the operational parameters of market making system.

Following recommendations were made by the Committee :

- All shares excluding the shares satisfying the criterion given below would be eligible for market making:-
  - a. Shares included in the BSE Sensex and in the Nifty;
  - b. Shares where the average number of trades is more than 50;
  - c. Shares where the value of trades on a daily basis is more than Rs. 10,00,000/-;
  - d. Shares where the company is not in operation and the networth erosion is beyond 50%.
- The market making activity would be voluntary in nature.
- The market maker shall provide two way quotes in the shares he or she has committed to undertake market making, at regular intervals of thirty minutes with a minimum depth of Rs. 5000/- or one market lot whichever is higher, within five days of the registration.
- The obligation of the market maker to make market, i.e. to give a two-way quote, would end at 1% less than the price band in that share.
- The market maker would operate in exclusively quote driven system. The market maker would, however, compete with other market makers on the exchange for trading in the share.
- The member brokers of the exchanges would be allowed to act as market maker.
- If a market maker fails to provide two way quotes for more than three consecutive days, his registration, as market maker, would stand cancelled.
- There would be a maximum of five market makers for a scrip on an exchange.
- The Committee felt that in case of IPOs, introduction of the market making could help the investors by giving them the assurance of liquidity. The detailed procedure for this would be worked out by SEBI.
- Margins would be applicable to the market maker as in the normal market.
- The exchanges would prescribe the capital adequacy norms to be commensurate with the type of shares, number of shares undertaken by the member for making market, infrastructure and volume of business of the member.
- The spreads between the bid and ask price would be as follows:-

| | For shares priced | | Maximum Spread |
|---|---|---|---|
| a. | Upto Rs. 10 | - | No limit |
| b. | >Rs. 10/- <Rs. 20/ | - | 10% |
| c. | >Rs. 20/- <Rs. 50/- | - | 5% |
| d. | >Rs. 50/- <Rs. 100/- | - | 4% |
| e. | >Rs. 100/- | - | 3% |

The Committee recommends that the guidelines enumerated above may be reviewed by SEBI from time to time keeping the operational experience in view.

- The market maker would be eligible to avail of lending/ borrowing facilities under the Stock Lending Scheme 1997. The market maker may also draw shares from the promoters in a fair and transparent manner.

- The Committee urged the investment institutions to encourage their broking subsidiaries to take up market making in order to aid and strengthen the activity.
- The exchanges have been asked to pursue with their Clearing Banks to open special cells for lending to the market makers with adequate safeguards. Committee strongly recommended the RBI to encourage banks to participate in lending to market makers.

The Committee recommended that all the stock exchanges should adhere to the recommendations regarding selection of shares, capital adequacy and price bands. For other recommendations stock exchanges may mould the scheme to make it more attractive to the market makers.

### *XII. On Line Trading Terminal abroad*

With the rapid expansion of the Indian capital market and with the fund managers all over the world evincing keen interest in investing in the Indian markets, a need was felt to provide a facility to eligible overseas investors to place orders on a real-time basis. Government of India, through its budget 1999-2000, unveiled a scheme to encourage brokers of stock exchanges to open on-line trading terminals abroad. In pursuance to this, SEBI has issued guidelines for opening and maintaining the trading terminals abroad. The salient features of the guidelines are:

- ***Eligibility Criteria***

Such trading terminals shall be opened only by the Stock Brokers registered with SEBI, and only after obtaining permission from the respective stock exchange.

- ***RBI Permission***

Such terminals abroad would be opened subject to the guidelines laid down by RBI from time to time.

- ***Permission by the Foreign Regulatory Authorities***

Such terminals shall be subject to prior permission of the concerned regulatory authorities of the respective foreign countries, wherever required.

- ***Operation of the terminals***

Any eligible investor (NRIs/OCBs/FIIs/PIOs) shall be able to place orders on the trading terminal of the Exchange available at the office of the Indian broker maintained abroad. The order fed on the live terminal shall be executed on the computer of the Exchange in India.

- ***Contract Note***

The contract note in favour of the client abroad shall be issued in India, however the same could be printed in the broker’s office abroad.

- ***Capital Adequacy, Margins System & Brokerage***

All such trades would be subject to usual margins, capital adequacy and intra-day trading limits and such other requirements fixed for the brokers by the exchange. The respective stock exchange shall ensure that investors do not pay brokerage on such trades exceeding the maximum brokerage permitted under rules, regulations and bye-laws of the exchange.

No Negotiated Deals shall be permitted through these terminals and only screen based order matching system shall be available on these terminals.

- ***Settlement Procedure***

All trades shall be settled in India in dematerialized form only. Clients with status of FIIs shall settle the trade through their registered custodian/

designated bank. Clients with the status of NRIs/ PIOs/*OCBs* shall settle the trade through a designated bank. Such a designated bank shall be responsible for repatriation of funds.

- ***Monitoring & Surveillance***

The respective exchange shall ensure that there is adequate monitoring and surveillance mechanism for such overseas terminals in order to oversee trades.

- ***Grievance Redressal Mechanism***

The investors' grievance for such cases shall be resolved by the respective Indian exchange through the existing arbitration mechanism.

- ***Jurisdiction***

The parties to such trade shall be deemed to have submitted to the jurisdiction of the Courts in India for the purpose of giving effect to the provisions of the Rules, Bye Laws and Regulations of the exchange.

### *XIII Long-term capital gains tax*

The long-term capital gains tax for resident Indians was 20% linked to a notional value of capital gains, computed with reference to a cost of inflation index. However the long-term capital gains for non-resident Indians was only 10%. In view of perceived discrimination in the rate between residents and non-residents, the Finance Act, 1999 amended the law to cap the long-term capital gains tax for resident Indians on transfer of shares and securities, at the 10% rate.

## TRADES ON STOCK EXCHANGES

The number of listed scrips increased marginally during 1998-99 from 9833 to 9877. Some of these securities are listed on a few exchanges and also permitted for trading by a few others.

Of the 9069 brokers registered with SEBI as on 31st March 1999, 3173 of them, accounting for 35% of total, were corporate entities. Nearly 87% of brokers on NSE were corporatised followed by OTCEI with 77%. Some of the brokers hold multiple memberships, i.e. they trade on more than one exchange. 7983 brokers have single membership while 444 double, 46 triple, 12 quadruple memberships. Only two members hold memberships on six exchanges.

### *Turnover*

Trading volumes at the stock exchanges have been witnessing phenomenal growth for last few years. It, however, slowed down to 13% during 1998-99. One sided turnover on all exchanges taken together exceeded Rs.1,000,000 crore during 1998-99.Turnover ratio increased from 154 to 178, which is now one of the best in the world. Selected indicators in secondary market may be seen in Table No.8 of Chapter 1.

The increase in turnover has not been uniform across exchanges, as may be seen from Table No.1. Many of the exchanges, in fact, recorded decline in turnover during 1998-99. Only 5 exchanges, viz. NSE, BSE, UP, OTCEI and Gauhati recorded increased turnover in absolute terms during 1998-99. Only BSE and UPSE improved their market share during the year. BSE made handsome gains, which came mostly from VSATs. The VSAT turnover accounted for over 40% of total turnover of BSE and this was mostly at the cost of small exchanges. NSE, however, continued to be market leader with over 40% of market share.

The sectoral distribution of turnover is also undergoing significant changes. According to a RBI study, the combined share of manufacturing companies and financial services sector in the aggregate turnover declined from 84% in 1991-92 to 34% in 1998-99, while that of information

| Table No. 1: Turnover on Stock Exchanges in India | | | | |
|---|---|---|---|---|
| Stock Exchange | Turnover (Rs. Crore) | | % share in Turnover | |
| | 1997-98 | 1998-99 | 1997-98 | 1998-99 |
| NSEIL | 369934 | 414383 | 40.71 | 40.49 |
| Mumbai | 207383 | 311999 | 22.82 | 30.49 |
| Kolkotta | 178778 | 171780 | 19.67 | 16.79 |
| Delhi | 67840 | 51759 | 7.47 | 5.06 |
| Ahmedabad | 30771 | 29734 | 3.39 | 2.91 |
| Uttar Pradesh | 15390 | 18627 | 1.69 | 1.82 |
| Pune | 8624 | 7453 | 0.95 | 0.73 |
| Bangalore | 8636 | 6779 | 0.95 | 0.66 |
| Ludhiana | 8315 | 5978 | 0.92 | 0.58 |
| Vadodara | 4576 | 1749 | 0.5 | 0.17 |
| Hyderabad | 1860 | 1276 | 0.2 | 0.12 |
| Cochin | 1783 | 773 | 0.2 | 0.08 |
| Coimbatore | 2136 | 395 | 0.24 | 0.04 |
| Chennai | 1228 | 370 | 0.14 | 0.04 |
| OTCEI | 125 | 142 | 0.01 | 0.01 |
| Bhubaneshwar | 202 | 77 | 0.02 | 0.01 |
| Jaipur | 431 | 65 | 0.05 | 0.01 |
| Gauhati | 20 | 30 | 0 | 0 |
| Mangalore | 308 | 11 | 0.03 | 0 |
| Madhya Pradesh | 1 | 1 | 0 | 0 |
| ICSEIL | 0 | 1 | 0 | 0 |
| Magadh | 323 | 0 | 0.04 | 0 |
| SKSE | 17 | 0 | 0 | 0 |
| **Total** | **908681** | **1023382** | **100** | **100** |
| | | | | ***Source: SEBI Annual Report 1998-99*** |

technology, pharmaceuticals and fast moving consumer goods increased sharply from 8% to 59%.

The turnover of Nifty scrips in March 1999 was higher by 63% over that in March 1998. The aggregate turnover of IT and pharmaceutical scrips increased 25 and 5 times respectively during the said period. Similarly, the turnover of Nifty scrips in December 1999 was higher by 78% over that in March 1999. The turnover of IT and pharmaceutical scrips increased 4 and 2 times respectively during the said period.

### *Small Exchanges*

As stated earlier, there are 24 exchanges today in the country. These have been recognised over a period of time to enable investors across the length and breadth of the country to access the market. In order to provide an opportunity to investors to invest in the securities of local companies, listing of companies on the local exchange was made mandatory. Growing regional aspiration of people and the policy of listing on regional exchange induced people to seek a new exchange in their locality. But with the advent of nation wide trading net-work of the NSE, which was possible because of adoption of world class technologies, both issuers and investors preferred to list and trade on exchanges providing nation wide network. This reduced relevance of regional exchanges and also their turnover as may be seen from Table No 2. NSE now reports a higher turnover in the region than that of most of the regional exchanges. BSE is also having substantial turnover in these regions through VSATs. Top six exchanges in aggregate account for over 98% of turnover in 1998-99. The turnover on remaining 18 exchanges is too low to justify their continued viability. Policies requiring listing of a security on a regional exchange and requiring a regional exchange to invest heavily on technology have kept smaller exchanges clinically alive.

With the fall in turnover, financial health of the exchanges is deteriorating, as may be seen from Table No 3. While the income of the regional exchanges is reducing, their expenditure is increasing because of increasing administrative and maintenance cost and increased investment on setting up on-line trading system, as prescribed by the regulator.

Protecting viability of smaller regional stock exchanges has been engaging the minds of the policy makers, because these exchanges have been recognised by them on being satisfied of the need for them and their viability. However, when the world is moving towards 24 hours trading through out the year, it is difficult to imagine survival of all 24 exchanges. Internationally, most small stock exchanges have either merged with larger ones, worked out alliances or have developed niche markets, which they can profitably serve. For example, in Canada, the four stock exchanges have agreed amongst themselves to serve a specific market segment – the Toronto Stock Exchange is the senior equities exchange; the Montreal Stock Exchange is the derivative exchange and the VSE and the ASE have merged to form a new venture exchange, called Canadian Venture Exchange.

### *Market Fragmentation*

The existence of 24 exchanges with their regional peculiarities to some extent fragment the market and thereby disperse liquidity. As a result the same security is quoted at widely different prices at the same time, as may be seen in Table No. 4, because of differences in local demand and supply conditions and differences in settlement periods and system. The price differential on two largest stock

**Table No. 2: Turnover on Regional Exchanges Vs. NSE Terminals in the Region** *(Rs. Crore)*

| Exchange City | Average Monthly Turnover | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1996-97 | | 1997-98 | | 1998-99 | | April-June 1999 | |
| | NSE | Exchange | NSE | Exchange | NSE | Exchange | NSE | Exchange |
| Bhubaneswar | 3.63 | 38.50 | 45.64 | 33.45 | 34.10 | 6.42 | 30.95 | 6.23 |
| Gauhati | 3.81 | 40.33 | 64.03 | 1.72 | 65.57 | 2.5 | 48.01 | NIL |
| Jaipur | 137.79 | 126.60 | 291.77 | 35.92 | 362.02 | 5.25 | 445.82 | NIL |
| MPSE | 246.69 | 0.09 | 178.05 | 0.10 | 273.91 | 0.075 | 423.34 | Negligible |
| SKSE | 54.79 | 32.92 | 207.14 | 1.55 | 177.01 | NIL | 183.23 | NIL |
| Cochin | 149 | 116 | 199 | 148 | 223.36 | 64.42 | 282.54 | 61.01 |
| Coimbatore | 551 | 199 | 352 | 178 | 316.08 | 32.89 | 262.61 | 22.8 |
| Hyderabad | 674 | 40 | 733 | 155 | 1053.98 | 106.32 | 1128.55 | 49.35 |
| Chennai | 1132 | 192 | 1404 | 102 | 1443.1 | 30.80 | 1369.34 | 8.93 |
| Mangalore | 5 | 31 | 40 | 25 | 41.12 | 0.94 | 45.04 | NIL |
| Magadh | 0.97 | 229.58 | 37.00 | 26.92 | 51.94 | Negligible | 47.59 | Negligible |

| Table No. 3: Financial Health of Small Exchanges (In Rs. Lakh) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Exchange City | 1996-97 | | 1997-98 | | 1998-99 | | % change from 1996-97 to 1998-99 | |
| | Income | Expenditure | Income | Expenditure | Income | Expenditure | Income | Expenditure |
| Bhubaneshwar | 112.33 | 54.13 | 117.69 | 69.52 | 111.64 | 68.16 | -0.99 | 25.92 |
| Gauhati | 54.17 | 43.48 | 58.00 | 56.10 | 55.33 | 47.79 | 2.14 | 9.92 |
| Jaipur | 282.52 | 135.28 | 217.65 | 127.38 | 220.22 | 154.92 | -22.05 | 14.52 |
| MPSE | 86.61 | 63.64 | 102.02 | 121.99 | 76.13 | 101.82 | -12.10 | 59.99 |
| OTCEI | 1040.02 | 1947.95 | 741.53 | 1354.46 | 592.78 | 1302.24 | -43.00 | -33.15 |
| SKSE | 170.40 | 100.13 | 121.14 | 147.95 | 125.80 | 184.05 | -26.17 | 83.80 |
| Cochin | 168.19 | 171.12 | 209.42 | 39.66 | 153.30 | 256.65 | -8.85 | 49.98 |
| Coimbatore | 340.47 | 150.68 | 220.47 | 234.13 | 155.89 | 237.93 | -54.21 | 57.90 |
| Hyderabad | 403.65 | 344.48 | 238.66 | 359.30 | 191.72 | 282.94 | -52.50 | 18.56 |
| Chennai | 345.58 | 291.84 | 336.52 | 263.13 | 331.89 | 200.29 | -3.96 | -31.37 |
| Mangalore | 71.84 | 82.25 | 62.01 | 72.18 | 50.13 | 63.54 | -30.21 | -22.74 |
| Magadh | 50.72 | 41.01 | 46.07 | 51.29 | 33.86 | 55.57 | -32.24 | 35.50 |

| Table No. 4: Arbitrage Opportunities on 30th December 1999 | | | |
|---|---|---|---|
| Scrip | Price | | Differential |
| | On BSE | On NSE | |
| Hind Lever | 2250.00 | 2136.00 | 113.40 |
| Dabur India | 1180.00 | 1100.00 | 80.00 |
| Wipro Ltd. | 2600.80 | 2522.40 | 78.40 |
| Mastek | 4605.70 | 4546.20 | 59.50 |
| Visualsof(I) | 8215.70 | 7822.95 | 392.75 |
| Ravalgaon | 4566.40 | 4257.00 | 309.40 |
| Widia(I) Ltd | 1847.40 | 1705.00 | 142.40 |
| Mico | 5121.00 | 5000.00 | 121.00 |
| NIIT Ltd | 3386.80 | 3315.55 | 71.25 |

*Source : Economic Times, 31st December, 1999*

exchanges viz. NSE and BSE at times works out 7% of the price, offering tremendous arbitration opportunities. For example, the price of Visuals of (I) on BSE differed from that on NSE by Rs. 393.75 on 30th December 1999. The prices of Dabur India on two exchanges on the same day differed by more than 7%.

### *Market Capitalisation*

All India market capitalisation registered a marginal decline during 1998-99. It declined by nearly 3% from Rs. 589,816 crore to Rs. 574,064 crore. It reached a minimum of Rs. 476420 crore at the end of November 1998. The market capitalisation ratio declined further from 37.7% in 1997-98 to 34.1% in 1998-99. The market capitalisation during April-December 1999 has registered handsome increase to approach Rs. 10,000,000 crore. The market capitalisation of securities listed on NSE at the end of December 1999, which is estimated at Rs. 852,985 crore, accounts for 87% of total market capitalisation of the country. The market capitalisation on NSE, where only 1237 scrips are available for trading as against 5858, exceeded that on BSE since November 1999.

Traditionally, manufacturing companies and financial services sector accounted for major portion of market capitalisation. However, in the recent past, the importance of these traditional sectors has declined and the new sectors like information technology, pharmaceuticals and fast moving consumer goods have picked up. The market capitalisation of IT companies has risen to dizzy heights. For example, the market capitalisation of Wipro increased from Rs. 656 crore at the end of 1995 to Rs. 8479 crore at the end of 1998 and further to Rs. 58,401 crore at the end of 1999. Similarly, the market capitalisation of Infosys increased from Rs. 273 crore at the end of 1995 to Rs. 4754 crore at the end of 1998 and further to Rs. 47,898 crore at the end of 1999.

While all India market capitalisation declined during 1998-99, the market capitalisation of FMCG, Pharmaceuticals and IT scrips increased by 70%, 106% and 315% respectively. Similarly, While all India market capitalisation increased by 74% during April-December 1999, the market capitalisation and IT scrips increased by 310%

***Trends in Prices***

The year 1998-99 generally witnessed a declining trend, as reflected by movement of indices in the Table No.5. The Sensex and Nifty recorded a decline of 3.92% and 3.44% during the year. These indices registered a declining trend till November 1998 since when the trend got reversed. Prices firmed up gradually since December 1999 on the expectations of Budgetary incentives as well as positive budget proposals, FII net inflows, exchange rate stability, increased dematerialisation and increased liquidity in the market. During April-December 1999, the market remained buoyant through out with Sensex and Nifty recording handsome gains by 34% and 38% respectively. The Movement of indices during this year seems to be in tune with international markets.

A SEBI study has revealed that the average mean daily returns ranged between 0.4% to 0.7% during 1985-98. It is higher than that of most of the Asian markets except China and comparable to the developed markets. The returns after 1991 are higher than most of the emerging markets except China.

The market witnessed a few spates of high volatility in the recent part. The most pronounced volatility was observed during June 1998 when volatility of Nifty as well as Sensex exceeded 5%. Stringent anti-volatility measures like volatility margin and concentration margin, initiated by SEBI brought down volatility of Nifty and Sensex to 1.53% and 1.83% respectively. May 1999 again witnessed high volatility with Nifty volatility going up to 5.30%. It may, however, be noted that Nifty volatility remained always lower than the Sensex volatility. The volatilities of the indices are presented in Table No. 6 and in Figure 1.

The volatility across the scrips varied widely. For the month of March 1999, while the Nifty volatility

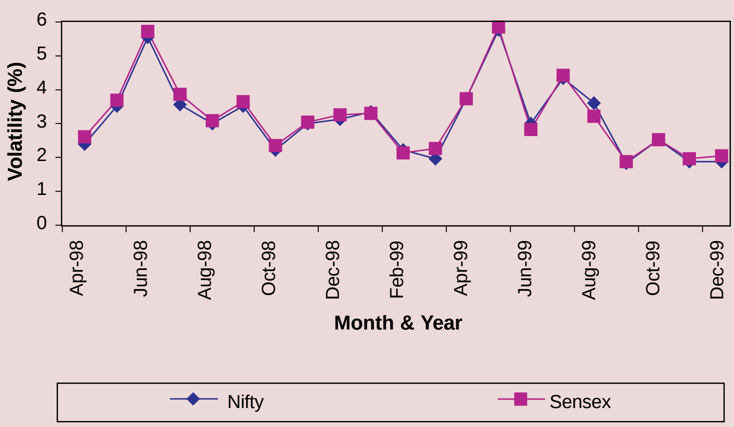
**Table No. 5: Movement of Select Indices on Indian/Foreign Markets**

| Index | 31.3.98 | 31.3.99 | 31.12.99 | Change during 1998-99 (%) | Change during April-Dec 1999 (%) |
|---|---|---|---|---|---|
| Sensex | 3892.75 | 3739.96 | 5005.82 | - 3.92 | 33.85 |
| Nifty | 1111.85 | 1073.65 | 1480.45 | - 3.44 | 37.89 |
| Hanseng | 11518.68 | 10942.20 | 16962.10 | - 5.00 | 55.02 |
| DJ | 8799.81 | 9786.16 | 11452.86 | 11.21 | 17.03 |
| Nikkei | 16527.17 | 15836.59 | 18934.34 | - 4.18 | 19.56 |
| FTSE | 5932.20 | 6295.30 | 6930.20 | 6.12 | 10.09 |

| Table No. 6: Stock Market Volatility since April, 1998 | | | | | | |
|---|---|---|---|---|---|---|
| **Month** | **Index** | | **Volatility (%)** | | **Market Capitalisation (Rs. Crore)** | |
| | **Nifty** | **Sensex** | **Nifty** | **Sensex** | **On NSE** | **All India** |
| April 1998 | 1159 | 4007 | 1.96 | 2.17 | 516805 | 610777 |
| May | 1063 | 3686 | 3.09 | 3.24 | 502014 | 591420 |
| June | 942 | 3251 | 5.11 | 5.26 | 424697 | 511012 |
| July | 931 | 3211 | 3.12 | 3.45 | 425006 | 508863 |
| August | 853 | 2933 | 2.57 | 2.66 | 406291 | 489355 |
| September | 905 | 3103 | 3.10 | 3.21 | 425100 | 504959 |
| October | 824 | 2812 | 1.81 | 1.93 | 394316 | 476609 |
| November | 818 | 2811 | 2.58 | 2.60 | 389442 | 476240 |
| December | 884 | 3055 | 2.69 | 2.85 | 419865 | 477010 |
| January 1999 | 966 | 3275 | 2.91 | 2.87 | 449221 | 528896 |
| February | 981 | 3289 | 1.79 | 1.70 | 452081 | 530772 |
| March | 1078 | 3689 | 1.53 | 1.83 | 491175 | 574064 |
| April | 978 | 3450 | 3.31 | 3.30 | 445380 | 513925 |
| May | 1132 | 3880 | 5.30 | 5.41 | 503911 | 590489 |
| June | 1188 | 4067 | 2.59 | 2.41 | 529468 | 615566 |
| July | 1310 | 4526 | 3.90 | 3.98 | 593651 | 683086 |
| August | 1412 | 4663 | 3.19 | 2.78 | 668187 | |
| September | 1385 | 4725 | 1.43 | 1.45 | 686740 | |
| October | 1433 | 4835 | 2.09 | 2.11 | 670062 | |
| November | 1365 | 4589 | 1.45 | 1.55 | 726419 | |
| December | 1480 | 4802 | 1.43 | 1.63 | 852985 | |

*Source : SEBI Newsletter*

**Figure 1: Stock Market Volatility since April 1998**



was 1.53%, the volatility of IT and Pharmaceuticals scrips in the Nifty was 3.36% and 2.88% respectively. Similarily during December 1999, the Nifty volatility was 1.42% while that of IT and Pharmaceuticals scrips was 2.46% and 2.07% respectively.

A SEBI study has revealed that inter-day volatility (close-close or open-open) is higher than intra-day volatility. Open-open inter-day volatility is highest of all inter and intra-day volatilities.

### *Price Manipulation*

Many companies are closely held and not listed on stock exchanges. A small percentage of listed scrips are traded. Floating stock in the market is not large, while the market is dominated by FIs, FIIs and a group of bulls and bears, some of whom are primarily interested in unhealthy speculation rather than healthy trading. Large sale or purchase by some of them, at times in concert, does inject the market with a speculative overtone, as evidenced by manifold rise in prices of BPL, Videocon, Pentafour, Sterilite etc. during May-June 1998. Of the 55 cases taken up by SEBI for investigation during 1998-99, 40 related to price manipulation and price rigging.

The market remains plagued during certain periods by high volatility and price manipulations. It is reflected by the ratio of High to Low during a period. A ratio of 2 – 3 during a year is observed in a large number of securities indicating that the share prices rise to more than double or fall to less than half during a year. A high-to-low ratio as high as 7 was observed in respect of even index scrips (although IT scrips) during 1998-99. Such high fluctuations point at divergence of prices from the fundamentals.

In a recent survey conducted by the Society for Capital Market Research and Development among a cross-section of companies, as high as 83 per cent of the responding managements, cutting across all size and age-groups of companies, answered 'yes' to a question whether the Indian equities market is "frequently manipulated despite SEBI's regulations''. Nearly 86 per cent of the respondents agreed that Indian market is "more speculation-oriented than investment-oriented'' and about 62 per cent felt that the market is "excessively volatile''.

Incidence of price manipulation can be traced to large-scale unhealthy speculative trades. The extent of speculation can be gauged by the deliveries at the end of settlement. During 1998-99, delivery took place in respect of 13% of trades by value. The rest were squared up. It may be noted that delivery based trades are generally done by the investors while non-delivery based trades by the speculators including brokers. In advanced countries, transactions on customers' account constitute over 70% while on members account less than 30%. Though this is not strictly comparable, it gives an indication of the extent of speculation. Factors responsible for speculation in Indian market are : (a) large scale aggressive speculations, (b) squaring up facility in the settlement system, (c) long settlement period, (d) carry forward facility (e) different settlement cycles on different stock exchanges and (f) low margin requirement. For example, an operator may do any amount of short selling or accumulate a long position and square up the trades before the end of the settlement period. Even if he is required to give delivery, he has the option to carry forward to next settlement period or shift position from one exchange to another. The introduction of the on-line trading has also resulted in the sharp increase in speculative transactions. Since the orders are executed at quick pace, a large number of traders indulge in short term speculation in the active scrips. Some speculative demand may assist the liquidity and efficiency of market, but too much of speculation conflicts with allocational efficiency. If speculation is to be harnessed for socially beneficial purposes, the settlement period should be shortened by shifting to rolling settlement.

### *Market Concentration*

The top 10 scrips accounted for as much as 74% of total turnover on NSE during June 1998. This reduced gradually to 53% in August 1999. Top 100 scrips account for about 98% of turnover. “A” group shares, which is about 150 in number, accounted for 99.4% of turnover on the BSE during 1997-98. It reduced to 94% in 1998-99 and further to 91% during April-December 1999, as may be seen from Table No. 7. There appears to be slight diffusion in trading in the recent past. The turnover in several stocks has been negligible. This suggests illiquidity in such stocks, which indicates their poor quality.

**Table No. 7: Distribution of Turnover on BSE**

| Year | Specified Securities | Unspecified Securities | Share of Specified | Share of Unspecified |
|---|---|---|---|---|
| 1994-95 | 15456 | 52292 | 22.8 | 77.2 |
| 1995-96 | 26696 | 22723 | 54.0 | 46.0 |
| 1996-97 | 118763 | 5426 | 95.6 | 4.4 |
| 1997-98 | 205957 | 1156 | 99.4 | 0.6 |
| 1998-99 | 292248 | 18501 | 94.0 | 6.0 |
| Apr-Dec 1999 | 387178 | 36249 | 91.0 | 9.0 |

**Table No. 8: Trading Profile on NSE, 1998-99**

| | Representation by Market Capitalisation | | Representation by Turnover | |
|---|---|---|---|---|
| Top ‘N’ Companies | Market Cap (Rs. Crore) | Turnover (Rs. Crore) | Market Cap (Rs. Crore) | Turnover (Rs. Crore) |
| **5** | 24.62 | 25.14 | 10.94 | 52.28 |
| **10** | 34.96 | 33.62 | 14.13 | 67.12 |
| **20** | 47.92 | 41.24 | 32.66 | 81.12 |
| **50** | 67.72 | 76.72 | 50.77 | 92.05 |
| **100** | 79.45 | 90.81 | 64.85 | 96.00 |
| **500** | 97.58 | 99.30 | 94.90 | 99.49 |

Trading profile of the scrips listed on NSE, as presented in Table No. 8 reveals a somewhat similar story. Top 5 srips in terms of equity base with 25% of market capitalisation accounted for 25% of turnover on NSE during 1998-99. However, top 5 scrips in terms of turnover with 52% of turnover accounted for 11% of market capitalisation.

The trade is diffused in advanced countries. In case of Japan, thirty most active scrips account for 19.4% in volume and 24.6% in value during 1996. The extent of market concentration may be seen from Table No. 9. Ten most active scrips accounted for 52% of turnover in India and top ten scrips in terms of equity base accounted for 33% at the end of 1998.

Liquidity or more appropriately, illiquidity becomes apparent if one looks at the number of scrips traded. 51% of the scrips listed (6998) on the BSE were not traded even for a single day during March 1998. Of about 900 scrips listed on Hyderabad Stock Exchange, there have been no trade in respect of

**Table No. 9: Market Concentration in Asian Emerging Markets: End 1998**

| Market | Index Stocks Share of | | Share of 10 Largest Stocks Market Cap | Share of 10 Active Stocks in Turnover |
|---|---|---|---|---|
| | Market Cap | Turnover | | |
| China | 45.0 | 26.0 | 17.5 | 5.5 |
| Thailand | 73.7 | 69.1 | 45.8 | 42.3 |
| Taiwan | 61.4 | 44.4 | 27.3 | 19.9 |
| Korea | 74.9 | 68.2 | 37.9 | 24.1 |
| Malaysia | 60.5 | 69.2 | 31.5 | 31.0 |
| India | 66.4 | 74.1 | 33.2 | 51.7 |

***Source: Emerging Stock Markets Factbook 1999***

577 for more than a year. 655 scrips were not traded even once during last six months of 1998. 150 scrips have not been traded at all since their listing. No trade takes place on a few exchanges like Gauhati, Patna, Saurastra & Kutch who are surviving only on listing fees paid by companies. Situation is, however, quite different on NSE, where most of the scrips available for trading are in fact traded. over 95% of the scrips available for trading on NSE are traded every month.

These facts seem to indicate that trading is concentrated on only a limited number of stocks and is very thin in a large number of stocks.

### *Foreign Institutional Investors*

Though the volume of trades done by FIIs is not relatively very high, their dominance is felt because they do only delivery based trades. During 1998-99, they were net sellers with a divestment of Rs. 1,585 crore. Since December 1998, there was positive inflows, which helped the market to improve. Trends in purchases and sales by FIIs are presented in Table No. 10. During the current financial year, inflows have been by and large positive. Total inflows during April-December 1999 is estimated at Rs. 1617 crore. The cumulative net FII investment exceeded US$ 10 billion by the end of 1999.

### *Corporate Governance*

Many listed companies do not comply with all the conditions of listing. Some do not comply with deliberately so that they could be delisted. Investors are taken for a ride as the exchanges resort to delisting on flimsy grounds like non-submission of annual reports or non-payment of listing fee. Large scale delisting of companies, which ultimately harm the investors, made SEBI frame fresh guidelines for listing and delisting, as stated earlier. As the process of delisting, both volunary and compulsory, is stringent, the incidence of delisting has reduced. But compliance with listing agreement has not improved. BSE has created new a category called “Z” group to which it shifts the companies who do not comply with conditions of the listing agreement. So far BSE has shifted about 600 companies. The Securities Laws (Amendment) Act, 1995 obligates the person, on whose application securities are listed on a exchange, to comply with the conditions of listing agreement. This provision has never been used to take such person to task if he has failed to comply with the listing agreement. If investors are to be retained in the market, stock exchanges have to enforce listing agreement and through this, corporate governance can be improved.

## INTERNET BROKING

Now that most of the participants in the securities market, viz. Stock exchanges, Clearing Corporation, Custodians, Depository and Depository Participant, Clearing Banks are wired and information flows among them on real time basis, the next step is to loop the investors in to this network. This can be done through web based solution. Internet will have two major implications. Trading platform which was converted from trading hall to computer terminals at the brokers premises would be further shifted to the homes of investors. An investor will know precisely when and what rate his order was processed. This will create an end-to-end audit trail and boost confidence of investor significantly.

SEBI Committee on Internet–Based Securities Trading and Services has favoured the use internet as an Order Routing System (ORS) for communicating clients orders to the exchanges through brokers. This ORS would be compatible

| Table No. 10 : Trends in FII Investments | | | | | |
|---|---|---|---|---|---|
| | Gross Purchases (Rs. Cr.) | Gross Sales (Rs. Cr.) | Net Investment (Rs. Cr.) | Net Investment US$ M at monthly exchange rate | Cumulative Net Investment US$ M at monthly exchange rate |
| 1992-93 | 17.4 | 4.0 | 13.4 | 4.2 | 4.2 |
| 1993-94 | 5,592.5 | 466.3 | 5,126.2 | 1,634.0 | 1,638.2 |
| 1994-95 | 7,631.0 | 2,834.8 | 4,796.3 | 1,528.3 | 3,166.5 |
| 1995-96 | 9,693.5 | 2,751.6 | 6,942.0 | 2,035.7 | 5,202.2 |
| 1996-97 | 15,553.9 | 6,979.4 | 8,574.5 | 2,431.9 | 7,634.1 |
| 1997-98 | 18,694.7 | 12,737.2 | 5,957.5 | 1,649.4 | 9,283.6 |
| 1998-99 | 16,115.1 | 17,699.4 | (1,584.5) | (386.6) | 8,897.0 |
| | **73,298.1** | **43,472.7** | **29,825.4** | **8,896.9** | **35,825.8** |
| Apr-98 | 1,294.0 | 1,392.4 | (98.4) | (24.8) | 9,259.5 |
| May-98 | 845.9 | 1,729.7 | (883.7) | (218.4) | 9,041.2 |
| Jun-98 | 802.3 | 1,638.7 | (838.4) | (198.0) | 8,843.2 |
| Jul-98 | 1,309.8 | 1,226.1 | 83.7 | 19.7 | 8,862.9 |
| Aug-98 | 813.6 | 1,270.6 | (457.0) | (106.9) | 8,756.0 |
| Sep-98 | 1,453.4 | 1,312.0 | 141.3 | 33.2 | 8,789.2 |
| Oct-98 | 1,073.7 | 1,672.2 | (598.4) | (141.4) | 8,647.9 |
| Nov-98 | 1,039.1 | 1,239.0 | (199.9) | (47.2) | 8,600.6 |
| Dec-98 | 1,345.8 | 1,135.8 | 210.0 | 49.3 | 8,650.2 |
| Jan-99 | 1,642.3 | 1,189.4 | 452.9 | 106.4 | 8,756.5 |
| Feb-99 | 1,647.8 | 1,323.2 | 324.5 | 76.3 | 8,832.9 |
| Mar-99 | 2,847.4 | 2,570.4 | 276.9 | 65.2 | 8,892.5 |
| Apr-99 | 2,519.3 | 1,656.8 | 953.5 | 223.2 | 9,122.8 |
| May-99 | 4,108.3 | 2,389.0 | 1,719.1 | 402.0 | 9,523.4 |
| Jun-99 | 2,670.0 | 2,581.3 | 88.6 | 20.5 | 9,543.9 |
| Jul-99 | 4,310.7 | 2,807.0 | 1,503.7 | 348.6 | 9,892.5 |
| Aug-99 | 2,714.1 | 2,836.1 | (122.0) | (28.2) | 9,864.4 |
| Sep-99 | 2,725.6 | 3,466.0 | 740.4 | (170.4) | 9,694.1 |
| Oct-99 | 3,535.4 | 4,142.0 | 607.0 | (139.5) | 9,554.9 |
| Nov-99 | 4054.4 | 2755.0 | 1299.2 | 299.1 | 9,837.5 |
| Dec-99 | 4556.2 | 2938.6 | 1617.6 | 372.7 | 10210.6 |

***Source : SEBI's Newletters***

with screen-based trading system available on exchanges. ORS would enable investors to place orders with his broker and would have control over the information and quotes and will be able to hit the quote on an on-line basis. Once the broker's system receives the order, it will be checked electronically about the authenticity of the client and then routed to the appropriate exchange for execution. On execution of the order, confirmation would be sent on real time basis. Investor will also receive reports on margin requirement, payments and delivery obligations through the system. His ledger and portfolio account may also be up dated online.

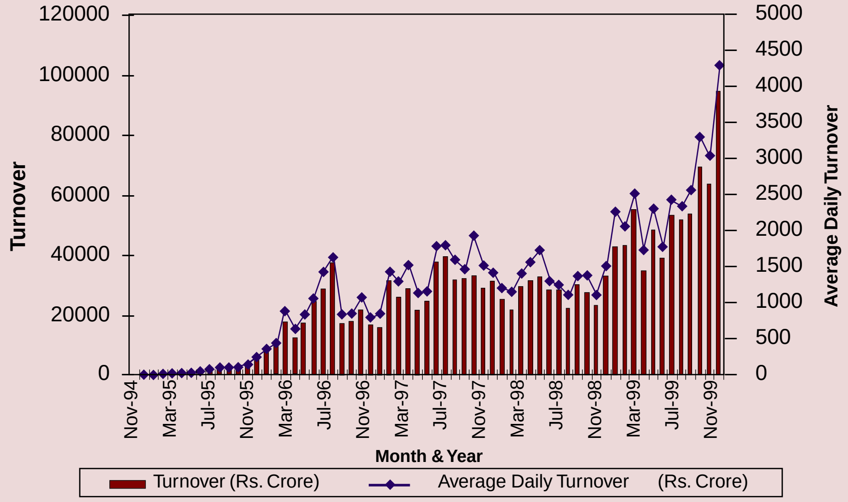
## LISTING OF FOREIGN COMPANIES ON INDIAN STOCK EXCHANGES

As there was no express prohibition in law on listing of Indian companies on foreign exchanges, a few Indian companies like Infosys, ICICI have got themselves listed on exchanges abroad. Similarly, since there is no express prohibition in law for listing of foreign companies on Indian stock exchanges, it is expected that foreign companies would be interested to list their securities on Indian stock exchanges. Rule 19 of the SC(R) Rules, 1957 which specifies requirements of listing, can specify the same in respect of foreign companies. Only a company which satisfies certain criteria like, it (a) is listed in the country of its incorporation, (b) prepares its accounts in rupee terms as per standards laid down by the Indian Chartered Accountants of India, (c) appoints a local share transfer agent for transfer and registration of shares, (d) subjects itself to jurisdiction of Indian Courts, may be listed on Indian exchanges.

## CAPITAL MARKET SEGMENT OF NSE

As stated earlier, NSE is the market leader in terms of turnover, market capitalisation and in terms of best market practices. NSE's dominant position becomes much more evident if the actual delivery volumes of all the stock exchanges operating in the country are kept in view. According to SEBI Annual Report of 1998-99, NSE accounted for a whopping 48% of all delivered value in the country. The growth of capital market segment of NSE is presented in Annexure – I and Figure 2. As may be seen from the Annexure, the market has witnessed phenomenal growth. The turnover on NSE increased from Rs. 3699 billion in 1997-98 to Rs. 4,144 billion in 1988-99. During first nine

**Figure 2: Growth of Business on CM Segment**



| Table No. 11:City-wise Distribution of Turnover | | | |
|---|---|---|---|
| **City** | **Percentage Contribution** | | |
| | **1998-99** | **1997-98** | **1996-97** |
| Mumbai | 39.83 | 38.11 | 40.81 |
| Delhi/Ghaziabad | 18.99 | 19.78 | 21.86 |
| Kolkotta | 10.33 | 12.22 | 12.45 |
| Chennai | 4.18 | 4.55 | 4.62 |
| Hyderabad/ Secunderabad | 3.05 | 2.38 | 2.75 |
| Ahmedabad | 2.55 | 3.71 | 4.27 |
| Bangalore | 2.01 | 1.75 | 1.74 |
| Gajuwaka/ Vishakhapatnam | 1.29 | 1.21 | 0.53 |
| Pune | 1.19 | 1.49 | 2.09 |
| Jaipur | 1.05 | 0.95 | 0.56 |
| Kanpur | 1.00 | 0.82 | 1.08 |
| Coimbatore | 0.92 | 1.14 | 2.25 |
| Chandigarh/Mohali/ Panchkula | 0.85 | 0.30 | 0.02 |
| Baroda | 0.83 | 0.82 | 1.07 |
| Indore | 0.79 | 0.58 | 1.01 |
| Cochin / Ernakulam / Parur | 0.65 | 0.65 | 0.61 |
| Vijayawada | 0.54 | 0.43 | 0.18 |
| Rajkot | 0.51 | 0.67 | 0.22 |
| Nagpur | 0.32 | 0.27 | 0.15 |
| Surat | 0.31 | 0.27 | 0.20 |
| Ludhiana | 0.29 | 0.23 | 0.05 |
| Gurgaon | 0.25 | 0.18 | 0.01 |
| Amritsar | 0.21 | 0.19 | 0.07 |
| Meerut | 0.21 | 0.10 | 0.01 |
| Other Cities | 7.86 | 7.20 | 1.39 |
| **Total** | **100** | **100** | **100** |

months of the current year, the turnover (Rs. 5,288 billion) has registered about 100% growth over the corresponding period last year. The turnover during December 1999 has reached Rs. 986 billion.

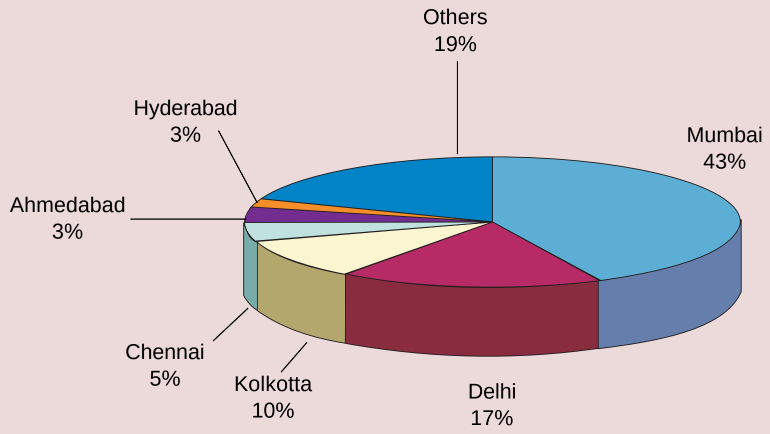
The growth in the monthly trading volumes in the dematerialised securities has also been commendable. The total traded volume in the dematerialised securities for the year 98-99 was Rs. 238 billion compared to Rs. 3 billion in the preceding financial year. The average monthly volume in the dematerialised securities was approximately Rs. 20 billion in 1998-99. The trend during 1998-99 was, however, very erratic. Demat turnover reduced from Rs. 180 crore in April 1998 to Rs. 52 crore in August 1998. It increased to Rs. 320 crore in December 1998, and further to Rs. 1,3191 crore in March 1999. It picked up further during the year 1999-2000 to register a handsome figure of Rs. 8,7170 crore in December 1999. Demat turnover accounted for over 88% of total turnover in December 1999. Such increase in demat trades is primarily due to SEBI requirement of compulsory trading in increasingly number of specified securities and enthusiasm of investors to get rid of ills of physical securities.

Capital market segment of NSE really provides a nation wide market as may be seen from Table No. 11. Less than 40% of trades is generated from Mumbai. Sizable trades are also generated from other metros like Kolkotta, Chennai and Delhi despite major stock exchanges in those cities. Figure 3 shows the city-wise distribution of turnover during December 1999.

## MARKET INDICES

Scientifically built and maintained indices having strong tradable characteristics lie at the heart of a vibrant derivatives market. Towards this end, India Index Services & Products Limited (IISL), promoted by NSE and CRISIL, has developed and been maintaining scientifically an array of indices, in technical partnership Standard & Poor's USA. The movement of two such widely used indices,

**Figure 3: City-wise Distribution of Turnover on Capital Market Segment: December 1999**




viz. S&P CNX Nifty and CNX Nifty Junior, in 1999 are discussed in this section. The S&P CNX Nifty and CNX Nifty Junior make up the hundred most liquid stocks in India. These were introduced in January 1996 and January 1997 respectively. S&P CNX Nifty is the largest first rung of the largest, highly liquid stocks. CNX Nifty Junior is an index built out of the next fifty large liquid stocks. S&P CNX Nifty is the front line blue chips, large and highly liquid scrips while the CNX Nifty Junior is the second rung of growth stocks, which are not as established as those in the S&P CNX Nifty. The maintenance of the S&P CNX Nifty and CNX Nifty Junior are so synchronised that a particular stock does not appear in both indices simultaneously.

### *Index Maintenance*

In Index maintenance, which is crucial for ensuring stability of the Index as well as in meeting its objective of being a consistent benchmark of the equity markets, IISL is guided by two technical Committees. Index Policy Committee comprising of representatives from IISL, NSE, CRISIL, S&P, noted academicians, experts in the field of mutual funds, brokerage houses and professionals who have experience in derivatives trading, looks into the macro issues pertaining to index management, and lays down broad operational guidelines for maintaining the indices. Index Maintenance Sub-Committee comprising of representatives from IISL, NSE, CRISIL and S&P, follows the guidelines laid down by the Index Policy Committee for carrying out the operational procedures for day to day index maintenance and dissemination of indices. The Index Maintenance Sub Committee ensures that the guidelines for Index Maintenance are adhered to, specially with regard to :

- Monitoring and completing divisor adjustments in a timely manner on account of corporate actions like stock splits, mergers/ amalgamations, etc.
- Monitoring and updating the indices database dynamically
- Index review, addition and deletion to the indices according to laid down criteria.

### *Trend in 1999*

The year 1999 has been eventful for the markets.