CHAPTER III

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India can rightly be proud of being the cradle of the oldest Stock Market in Asia, the Bombay Stock Exchange having been founded in 1875, while the Tokyo Stock Exchange, which is the second biggest stock exchange in the world, was established three years later in 1878. The main features of development of the Indian Capital Market are traced in this chapter.

3.1. Early Beginnings

The earliest records of security dealings in India are meagre and obscure. The origin of stock broking goes back to a time when shares, debentures and bonds representing titles to property or promises to pay were first issued on the condition of transfer from one person to another. The East India Company was the dominant institution in those days.

Brokers were not a numerous community and in Bombay, between 1840 and 1850, there were half a dozen brokers recognised by the banks and merchants. The leading broker, Shri.Premchand Roychand, was responsible for developing conventions and procedures. His was the mastermind in finance, which brought miracles on the stock exchange and he was called 'the Napoleon of Finance' (*Stock Exchange Monograph,* Bombay, 1995, P.2).

In 1850, the Companies Act introducing limited liability was passed and that heralded the commencement of joint stock companies in India. The 1850s witnessed a rapid development of commercial enterprise, which made investments in stocks and shares popular. There was perceptible increase in the volume of business in corporate stocks and shares.

In Bombay and Calcutta business was transacted in the shares of certain banks, cotton presses and in loan securities of East India Company. In Bombay, the business was conducted under a Banyan tree in front of the town hall. In Calcutta business was conducted under the shade of a Neem tree. Though the shades of the trees no longer cast shadows over the heads of the brokers, the roots have dug deep in to the cities and have spread to the rest of the country.

The American civil war (1860-61) totally stopped the supply of cotton from the U.S. to Europe. It resulted in a cotton famine and led to an unlimited demand on India. And the export proceeds in gold and silver served as fresh capital for a number of new ventures.

Table 3.1

New - Company Floatation, 1863-65

Kind of Company	No.	Paid-up Capital Rs. in Crore	Market Premia Rs.in Crore
Banks	25	13.64	10.94
Financial Associations	69	6.22	4.42
Land Reclamation Companies.	7	8.34	17.56
Miscellaneous Companies	30	1.56	5.00
Total	**131**	**29.76**	**37.92**

Source: *Stock Exchange Monograph*, Bombay, 1995, p.3.

As observed by the Bank of Bombay Commission in its report:

"The great and sudden wealth produced by the price of cotton shortly after the commencement of the American Civil War, coupled with the want of legitimate means of investment, was at this time producing its natural results in the development of excessive speculation....Everyone in Bombay appears to have become wild with the spirit of speculation. Companies were started for every imaginable purpose. –Banks and financial associations, land reclamation, trading, cotton cleaning, pressing and steamer companies and companies for making bricks and tiles" (*BSE Monograph,* P.3).

3.1.1. Share Mania of 1860s

The reckless lending policy of Bank of Bombay was imitated by others and it was responsible for the speculation that followed. Any scrip that was floated in the 1860s commanded a very high premium. Most of the banks and financial associations reached a premium of 50 per cent to 100 per cent without being tested by returns. Bank of Bombay share with Rs. 500/- paid up reached a high price of Rs. 2850/-.

Dazzled by the sudden and steep rise in prices many persons who had never held or dealt in shares before were attracted to the stock exchange. It was said that, "man and woman, master and servant, employee and employer, banker and merchant, trader and artisan, rich and poor, of all races and creeds, officials in high positions included, were deeply busy from day to day in the art of commuting bits of paper, variously called 'allotments', 'scrips' and 'shares' in to gold and silver" (*BSE Monograph*, P.4).

With the end of the American Civil War, a disastrous slump followed in India. Though the depression was long and severe, the share mania had certain lasting effects. The expansion of liquid capital and the establishment of a regular market in securities were its direct results and they helped to make Bombay the chief centre of the money and capital market and the financial capital of India.

3.1.2. Foundation of Bombay Stock Exchange

In 1860 there were about 60 brokers. In 1865 their number increased to about 250. Brokers were then a privileged class with great influence. The police had only 'salams' for them. But the slump that followed brought many failures and brokers decreased in number and prosperity. The police drove them from pillar to post.

In 1874, the brokers found a place now called Dalal Street, where they could conveniently assemble. On 9th July 1875, a few native brokers resolved to form an Association in Bombay, to protect the character status and interests of members, thus laying the foundation for the Bombay Stock Exchange. In 1887, the Articles of Association of the Exchange was constituted and thus the Stock Exchange was formally established in Bombay as a society to be called the "Native Share and Stock Brokers' Association". The exchange was established with 318 members. The number increased to 333 in 1986 and to 641 in 1997.

3.1.3. Establishment of Ahmedabad Stock Exchange

A number of cotton textile mills were started in Ahmedabad after 1880. Ahmedabad developed as the next important city in the Bombay Presidency. Many of the businessmen and a number of Bombay brokers hailed from Ahmedabad. In 1894, they formed themselves into an Association under the name of " The Ahmedabad Shares and Stock Brokers' Association".

3.1.4. Capital Market and Swadeshi Movement

The beginning of the 20^{th} century saw the birth of the 'Swadeshi' movement. The institution of, the Indian Industrial Conference in1905, in association with the Indian National Congress was the first definite sign of an alliance between economic and political discontent (Chaturvedi 17).

The 'Swadeshi' movement let loose a great wave of industrial enthusiasm in the country, and an important stage in industrial advance under Indian enterprise was reached with the inauguration of the Tata Iron and Steal Co. Ltd. in 1907. These developments were the backbone of the industrial progress to come and of the part to be played by the stock market.

3.1.5. Establishment of the Calcutta Stock Exchange

What the cotton textile industry was to Bombay, the jute industry was to Calcutta and jute mills sprang up on the banks of Hooghly. The boom in jute shares in 1861-65, was followed by a boom in tea and coal shares. At last, the boom broke in and a severe depression followed. The crisis that followed provoked disputes among brokers and ultimately led to a communal riot in 1908. It necessitated the need for an organised body, for mutual protection and safety. And so, an Association was formed by the leading brokers on 15th June 1908 under the name of "The Calcutta Stock Exchange Association".

3.1.6. The Madras Stock Exchange Ltd.

Though Madras Stock Exchange was organised in 1920, it went out of existence in 1923, for want of business.

The improvement in stock market activity in the 1930s led to the establishment of the 'Madras Stock Exchange Association' on 4th September 1937. It was recognised as a new company limited by guarantee on 29th April 1957.

3.1.7. The World War Booms

During the First World War, the import of manufactures into India stopped almost completely and a boom was ensured in all industries. Companies worked round the clock brought unprecedented prosperity and large dividends were declared. The stock exchanges soon became the centre of attention for all. The Second World War also touched off a brief sharp boom, which was followed by a slump. But the late 40s witnessed prosperity in different sectors and brought prosperity to the stock exchanges. Many new stock exchanges sprang up in different parts of the country.

3.1.8. Changing Indian Scenario

In the early years of independence, many foreign companies depended upon the London capital market for funds. The managing agency system, which was then in vogue performed the important functions, and the capital market played a limited role in the mobilisation of resources. However, this period witnessed the enactment of a number of basic legislations like Capital Issues (Control) Act, 1947, Securities Contracts (Regulation) Act, 1956 and Companies Act, 1956.

The development banking era began in India with the setting up of the IFCI in 1948. During the 1950s and 60s, the infrastructure for capital market was strengthened through the establishment of a network of development financial institutions such as ICICI, IDBI, UTI, SFCs and SIDCs.

The profile of the Indian Capital Market has changed considerably since the 1970s. The Multi- National Corporations (MNCs) operating in India were forced to dilute foreign holding under Foreign Exchange Regulation Act (FERA) of 1973. This dilution was perhaps the genesis of the equity cult, which gave a fillip to the Indian Capital Market.

The FERA legislation ensured that many well managed multinational companies offered their equities to the public at regulated low prices during the mid and late seventies. Encouraged by the good response to such issues, a large number of domestic companies offered new capital issues for public subscription.

The 1980s witnessed a period of change, signifying the widening and deepening of the market. Wider use of debentures and the emergence of public sector bonds imparted an additional dimension to the market. The capital market has undergone metamorphic transformation since the mid-eighties involving multi-dimensional growth. This attracted considerably large number of persons with small saving potential.

The initiation of the liberalisation process in India has triggered off developments of paramount importance to the capital market. The opening up of Indian economy, which began in the eighties, with one of the intentions of integrating it with world economy, picked up speed in the nineties.

Indian economy has been passing through a phase of industrial and economic liberalisation calling for implementation of various monetary and fiscal reforms. The process of liberalisation and deregulation which gathered momentum in India since 1984 offered new challenges to the various sectors.

Since July 1987, All India Financial Institutions and their subsidiaries and subsidiaries of banks have been admitted as members of stock exchanges.

The Securities and Exchange Board of India (SEBI) was constituted on 12th April 1988 to act as the watchdog of the capital market.

The Over The Counter Exchange of India (OTCEI) was set up in August, 1989 with a view to catering to the needs of companies with less capital.

During the 1990s, the Indian Capital market has been experiencing a process of structural transformation like computerised On Line Trading, Depository for scripless trading, promulgation of SEBI Act, etc. SEBI issued detailed guidelines for disclosure and investor protection in respect of new issues.

India's transition towards a more competitive market economy began in July 1991, with the introduction of the new economic policy. Large fortunes were made quickly in the corporate securities market during this period.

The Indian market was opened up for investment by the Foreign Institutional Investors (FIIs) in September 1992. A number of offshore funds have been floated for investing in the Indian capital market. In November 1992 the National Stock Exchange (NSE) was incorporated, with an equity capital of Rs.25 crore. The promoters of NSE are the Industrial Development Bank of India, the Industrial Finance Corporation of India, Life Insurance Corporation, the General

Insurance Corporations, the Stock Holding Corporation of India and the Infra-structural Leasing and Financial Services.

The establishment of NSE challenged the age-old supremacy of the Bombay Stock Exchange. NSE changed the way Indians traded in securities and emerged as a strong alternative to the B.S.E. The open outcry system of trading was replaced by the silence sophisticated computers. There has been a nation wide trading facility with equal access to investors from all over the country.

An important policy development regarding capital market was freeing of interest rates on convertible and non-convertible debentures.

The facility of carry-over has been suspended by SEBI effective from 13th March 1994. But a huge debate ensued about its pros and cons and later 'Badla' was brought back to the market in 1997.

3.2 Developments in the Secondary Market

The secondary market, usually referred to as stock market, is an important constituent of the capital market. An organised and well-regulated stock market performs the important economic functions of providing liquidity through adequate marketability and price continuity to shares dealt therein, ensuring safety and fair dealings in buying and selling of securities and assisting in the monitoring of firms.

The principles of this market are similar to all others. For every buyer there has to be a seller. When more people wish to buy than to sell, the price tends to rise, when fewer people wish to buy and many wish to sell, the price tends to fall.

Those who save need not always invest them in new issues. A portion of savings goes in the first instance into purchase of securities already issued. But it releases old savings, which can be invested in new issues. It is same as if it had been channeled into the new issue market. It is the function of the stock market to mobilise these savings and channel them for accelerating the economic development of the country. The recognised stock exchanges have played a further more direct part by participating in the initial distribution of new securities. The members of the stock exchanges have acted as underwriters and have been the principal agents for canvassing subscriptions from investors.

At present there are 22 stock exchanges in India recognised by the Government under the Securities Contracts (Regulation) Act 1956. They constituted an organised capital market for securities issued by the Central Government, State Governments, Public bodies and Joint stock Companies.

Table 3.2
Recognised Stock Exchanges in India,1998.

No.	Name	Place
1.	The Bombay Stock Exchange	Bombay
2.	The Ahmedabad Stock Exchange	Ahmedabad
3.	Bangalore Stock Exchange Ltd.	Bangalore
4.	The Calcutta Stock Exchange Asso.Ltd	Calcutta
5.	Cochin Stock Exchange Ltd.	Cochin
6.	The Delhi Stock Exchange Asso. Ltd	Delhi
7.	The Gauhati Stock Exchange Ltd	Gauhati
8.	The Hyderabad Stock Exchange Ltd.	Hyderabad
9.	Mangalore Stock Exchange Ltd.	Mangalore
10.	Ludhiana Stock Exchange Asso. Ltd	Ludhiana
11.	Madras Stock Exchange Ltd.	Madras
12.	Madhya Pradesh Stock Exchange Ltd	Indore
13.	The Magadh Stock Exchange Ltd.	Patna
14.	Pune Stock Exchange Ltd.	Pune
15.	The Uttar Pradesh Exchange Asso. Ltd	Kanpur
16.	Jaipur Stock Exchange Ltd.	Jaipur
17.	Bhubaneshwar Stock Exch. Asso Ltd.	Bhubaneshwar
18.	Saurashtra Kutch Stock Exchange Ltd.	Rajkot
19.	The Vadodara Stock Exchange Ltd	Baroda
20.	The Coimbatore Stock Exchange Ltd.	Coimbatore
21.	OTC Exchange of India	Bombay
22.	National Stock Exchange of India Ltd.	Bombay

Source: BSE *monograph*, P. 38

3.2.1. Growth Pattern of Listed Capital

Today India has become an important market in the emerging capital markets of the world in terms of market capitalisation and turn over. The number of stock exchanges in India increased from 7 in 1946 to 22 in 1998. The growth pattern of stocks and shares, of joint stock companies listed, are reflected in table 3.3. This also shows the structural pattern of listed stock on important stock exchanges in India. By any measure, Bombay Stock Exchange remains the largest exchange in India. Other leading exchanges in India are Culcutta, Delhi, Ahmadbad and Madras.

3.2.2. Mutual Funds and Securities Market

The institutionalisation process has added large number of institutions such as Mutual Funds through which the investors have been routing their investment rather than participating directly. The Unit Trust of India set up in 1964 is the first mutual fund. Subsequently, in 1987, the banks and financial institutions were allowed to set up mutual funds as subsidiaries. The private sector was allowed to enter into mutual fund industry since 1992-93.

Table 3.3

Structural Pattern of Listed Stock (As on 31st March, 1995)

Exchanges	Comp. Listed	No of Stock Issues				Capital listed (Cr.Rs)				Market Value (Cr.Rs)			
		Equity	Deb./ Bonds	Pref.	Total	Equity	Deb./ Bonds	Pref.	Total	Equity	Deb./ Bonds	Pref.	Total
Bombay	4702	6798	1649	238	8685	61514	28482	180	90176	435481	33177	179	468837
Calcutta	3115	3951	452	247	4650	41666	63773	138	105557	324374	64275	127	388776
Delhi	3137	4465	299	179	4943	51091	11220	122	62433	325775	11492	116	337383
Ahmedabad	2410	3745	606	74	4425	37321	16917	78	54316	252407	19692	85	272184
Madras	1267	1840	275	65	2180	36613	10944	35	47592	248690	11866	35	260591
Hyderabad	547	547	45	26	618	14962	1832	70	16864	54057	1903	70	56030
M. Pradesh	140	140	21	5	166	1203	607	4	1818	9216	516	8	9740
Bangalore	456	462	138	42	642	17441	6610	47	24098	95370	7662	47	103079
Pune	131	131	44	9	184	3259	1583	9	4851	32540	1764	10	34315
Cochin	**175**	**178**	**41**	7	**226**	**6224**	**2950**	**3**	**9177**	**64887**	**3350**	**3**	**68240**
Ludhiana	299	299	26	0	325	5624	521	0	6145	31537	631	0	32168
U.Pradesh	798	798	0	0	798	12081	0	0	12081	54300	0	0	54300
Guwahati	218	307	9	6	322	1638	993	1	2632	35946	955	1	36902
Patna	46	46	12	4	62	2643	670	2	3315	10328	600	2	10930
Bhubaneswar	45	48	3	1	52	3349	58	1	3408	7407	36	1	7444
Baroda	363	363	10	0	373	5705	721	0	6426	25044	716	0	26120
Jaipur	513	513	38	11	562	11724	1884	63	13671	27245	1903	63	29211
Rajkot	68	69	9	0	78	2405	853	0	3258	5537	1817	0	7354
Coimbatore	106	106	3	2	111	532	37	5	574	2808	37	5	2850
All India	99077	11407	2145	633	14185	79361	95100	358	174919	538711	100479	367	639575

Source: *Stock Market Today*, Stock Exchange , Bombay, 1995, P.28.

In 1996-97, there were 32 mutual funds in India (including UTI). Of these, 9 were in the public sector and 23 in the private sector. In 1994-95, total resources mobilised by mutual funds stood at Rs.11,250 crore. Of this, UTI contributed 76 per cent, other public sector mutual funds 12 per cent and private sector mutual funds 12 per cent. However during 1995-96 and 1996-97, there was a reverse flow of funds from the mutual fund on account of sluggishness in the capital market (Mirsa 607).

In 1997-98, the resources mobilised by public sector mutual funds (other than UTI) aggregated Rs.529 crore, the private sector mutual funds moblised resources aggregating Rs.658 crore and UTI collected Rs.2119 crore. As on March 31, 1998, the total corpus of all 259 schemes (domestic mutual funds including UTI) stood at Rs.97,228 crore (*Annual Report,* RBI, 1997-98, Table 5.3).

3.2.3 The Stock Market Scam

Stock market is said to be efficient when it can match quickly vast numbers of stocks put forth by sellers with vast demands for stocks put forth by buyers. The stock market works largely on one broker's trust in another broker's word. The brokers in turn depend on the faith of the customers or investors. Occasionally this trust has been abused.

After the unprecedented boom in January-March, 1992, there came an equally unprecedented bust in the stock markets of the country during the third week of April 1992. A large number of investors incurred heavy losses on account of the bust.

The Stock market scandal of 1992 is the worst that has happened in India. What has happened in the megascam of 1992 was the deliberate siphoning of funds from some banks through the use of Banker's Receipts, forged and legitimate, and the crediting of account payee cheques intended to be used for specific purposes into other accounts for manipulative deals in the stock market.

Though the exact extent of the loss cannot be known, the first report of the Janakiraman Committee estimated that the amount diverted was Rs.3,078 crore. The Second interim report estimated the total amount involved in the scam at Rs.3,542.78 crore.

Despite the various steps taken to locate the segregated resources, an amount of Rs.3,000 crore is certainly big to be written off by the affected institutions. This is the price that had to be paid for system failure, ineffective monitoring and inspection.

The Central Bureau of Investigation (CBI) registered a total of eight First Information Reports (FIRs) in 1992. The FIRs filed relate to the following banks with the fraud amounts in each case being: State Bank of India (Rs. 669 crore), UCO Bank (Rs.90 crore) Standard Chartered Bank (Rs. 1240 crore) Canbank Financial Services (Rs.374 crore), Can bank Mutual Fund (Rs.104 crore), State Bank of Saurastra (Rs. 175 crore), SBI Capital Market Ltd.(Rs.105 crore), and National Housing Bank (Rs.1,214 crore). The principal acused are Harshad Mehta, Bhupen Dalal, Hiten Dalal, A.D.Narotham, T.B.Ruia and J.P Gandhi (Halayya 165).

It was the investor who was the real loser and not the promoters or middlemen. The whole episode affected the investment climate, repercussions of which are still being felt.

The greatest damage was done to the psyche of the common investors. The investors lost faith in the banks, stock markets and mutual funds. The have not yet recovered from that rude shock.

3.2.4 Foreign Institutional Investors

The process of institutionalisation has been further strengthened by participation of the Foreign Institutional Investors which were permitted to invest in Indian capital market in September 1992.The number of FIIs registered with SEBI /RBI went up sharply from one in November 1992 to 439 in March 1997. Their cumulative net investment as of end March 1997 stood at US $ 7.5 billion (Misra 689). Although the number of FIIs registered with the SEBI increased from 439 in March 1997 to 533 by March 1998, net aggregate investment fell 24.4 per cent in 1997-98 to Rs.5,914 crore (*Report on Currency and Finance*, RBI, 1997-98, P5.).

3.3 Developments in the Primary Market

The essential function of the Primary Market or the New Issues Market is to facilitate the transfer of investible funds from savers to entrepreneurs. Along with other financial institutions, the market for shares and debentures exert great influence in mobilising and allocating the nation's capital resources among numerous competing uses. The efficiency with which this allocative function is performed determines the overall growth and efficiency of the economy itself

(Baumol 2). The ideal primary market is one that gives 'fair' prices to projects. Hence, if a project is a scam, it should be able to get a very poor valuation from the market. A good project should be able to command a high valuation from the market (Shah 3).

There is no element of trading in primary market operations, and investors file applications and subscribe directly to equity or debt of a company. The issuer may be a new company or an existing one. The securities offered might be a new type or additional amounts of a security issued in the past. These securities absorb new funds for productive purposes.

The primary capital market was almost an assured return market. The Controller of Capital Issues (CCI) monitored and set the pricing of primary issues until May 29, 1992 when the Capital Issues (Control) Act 1947 was repealed. Companies came out with public issues invariably did well and investors made gains.

3.3.1. The Era of Free Pricing

Two events, which occupy considerable space in the history of Indian capital market, are the demise of the office of the Controller of Capital Issues and the emergence of free pricing of security issues. The average investor is not yet sophisticated enough to discriminate between the good and the not so good issues. During the 'boom years', the fly-by-night entrepreneurs, pass on sub-standard issues to gullible investors. Investors burn their fingers and mostly desert the market for sometime. This is hardly conducive to the promotion of savings and growth of the capital market in the long run.

A noteworthy feature of the new issue activity is that a spate of equity issues, particularly rights issues, have been made at high premium. In 1991-92, 58 equity issues were made with a premium amount of Rs. 227 crore. In 1992-93, 324 issues were made with a premium amount of Rs. 5184 crore. Towards the end of 1993, the premium was estimated to have constituted as high as 60 to 70 per cent of the total volume of issues (Bhole 30).

3.3.2 New Financial Instruments

A significant development in the capital market is the introduction of a wide variety of financial instruments. They include Secured Premium Notes (SPN) with detachable warrants, Non-convertible debentures with detachable equity warrants, Zero interest fully convertible debentures, Fully convertible cumulative preference shares, Preference shares with warrants, Secured zero interest partly convertible debentures with detachable and separately tradable warrants.

3.3.3 Other Developments

The Government and SEBI have introduced various measures for improving the working of the new issues market. Schedule II of the Companies Act, 1956 relating to disclosure of public issues of capital was amended in October 1991 to improve the standard of disclosure. The risks are also required to be classified into those which are specific to the project and internal to the issuer company and those which are external and not under the control of the issuer company.

Merchant bankers have been brought under statutory regulation, with effect from the 22nd December, 1992. All issues are required to be managed by at least one merchant banker functioning as the lead merchant banker.

A code for advertisements of capital issues was announced on the 11th October, 1993. The code requires the issue advertisement not to contain any information or language not contained in the offer document.

Credit rating has been made compulsory for all debt instruments with few exemptions. Four credit rating agencies also have been set up in the country.

The minimum percentage of public offer by a company for being listed on a stock exchange has been reduced from 60 % to 25 %. Besides the number of mandatory collection centres has been reduced from 58 to 30, which should include the places where stock exchanges are located. On October 29,1996, SEBI reduced the minimum application size for subscribing to a public issue to Rs.2,000 from Rs.5,000 to encourage small investors.

3.3.4 New Capital Issues

The amount of new capital issues by the corporate sector went up from Rs.285 crore in the fifties to Rs.728 crore in the sixties and further to Rs.992 crore in the seventies. During the eighties, the amount of capital issues aggregated Rs.23,357 crore. During the six year period 1991-92 to 1996-97, capital issues aggregated a staggeringly high level of Rs. 98,648 crore (Misra 357).

It may be noted that during the nineties, new capital issues by the corporate sector were high, reaching the peak level of Rs. 27,632 crore in 1994-95. However, prolonged bearish conditions in the stock market since mid September 1994 impacted upon the primary market. The prolonged sluggishness of the primary capital market during the latter part of the 1990s has been a matter of serious concern. Capital raised in the primary market has been showing a steady decline from Rs. 27,632 crore in 1994-95 to Rs.20,805 crore in 1995-96 to Rs.14,227 crore in 1996-97. In the eight months, April-December, 1997, the amount raised was Rs.3,092 crore. The number of stocks quoting below par value on the BSE were a record 3110 or about 50 per cent of listed stocks on the bourse as on 23-9-1996 (*Prime* data).

The sluggishness in the primary market notwithstanding, certain issues during the year 1997 were over-subscribed which suggests that the demand for new issues is not as much of a problem (Acharya 683).

The High Level Committee on Capital Markets in its meeting on 22nd December, 1997 reviewed the status of the primary market and noted the fact that while capital raised directly from the primary market was on the decline, the private placements were on the rise. The private placement market has shown a rise from Rs.13,361 crore in 1995-96 to Rs.15,066 crore in 1996-97.

3.4 Regulation of Stock Market

The earliest legislation to the stock market in India was introduced in 1865 when the Government of Bombay passed the special Act XVIII of 1865. The second step was taken after the First World War, when Lord Llyod, the then Governor of Bombay proposed the formation of a committee of appeal or control consisting of outside members also. But the exchange opposed any sort of external interference. This refusal led to the appointment of the Atlay Stock Exchange Enquiry Committee on the 14th September 1923.

3.4.1. The Atlay Committee

The report of the Atlay Committee unanimously recommended the constitution of a controlling authority. The committee remedied the defect of the chaotic condition of the exchange's rules, bye- laws and regulations. The committee stressed the necessity of framing and maintaining a systematic body of rules and regulations in the general interest of the investing public.

The Government of Bombay offered a charter on 21st July 1925. But the Exchange turned down the offer and it compelled the Government to initiate special legislation for controlling stock exchanges. The Bombay Legislative Assembly passed the Bombay Securities Contracts Control Act on 29th October 1925. It came into force in Bombay from 1st January 1926.

The Act authorised the Government to grant recognition to a stock exchange and to approve the rules and regulations. The Bombay Stock Exchange was granted statutory recognition on 14th May 1927. The Act remained in force till the Securities Contracts (Regulation) Act, 1956 was enacted and which came into force on 20th February 1957.

The Act permits only those Stock Exchanges, which have been recognised by the Central Government after being satisfied with the rules and regulations ensuring fair dealings and protection to investors.

Under the Act, the Government promulgated the Securities Contracts (Regulation) Rules, 1957, which provides the procedures of various activities of the exchange.

3.4.2 . Patel Committee

A 12 member committee under the chairmanship of Shri. G.S. Patel, was set up by the Central Government on 17th May, 1984 to present a comprehensive review of the functioning of Stock Exchanges and make recommendations. The committee submitted its report on 10th December 1985. Based on the recommendations, the Government issued a number of directives and guidelines to the stock exchanges. They related to matters such as bringing down the cost of public issue, listing, creation of customers' protection fund and insurance cover for members of stock exchanges.

3.4.3. The Securities and Exchange Board of India (S E B I)

In order to sustain the growth of the capital market and form the growing awareness into a committed group of investors, it was necessary to remove the trading mal-practices and inadequacies prevailing in the market. The abolition of the office of Controller of

Capital Issues (C C I) and the setting up of S E B I were the first steps in the move from control, to prudential regulation. It was also necessary to provide the investors with an organised and well - regulated market place.

In 1988, a comprehensive Bill on SEBI was introduced outlining its powers, functions and responsibilities, which became an Act in 1992. The powers and functions of S E B I were strengthened in phases. Its ambit covers recognition of stock exchanges, their rules, articles, voting rights and nomination of public representatives, stock exchange listing, and delivery contracts.

SEBI has been established on the line of Securities Exchange Commission of the U S A. The SEBI Act 1992 provides for establishment of Statutory Board with a Chairman and five members. SEBI has been given autonomous status by treating it as a body corporate with perpetual succession and a common seal.

The preamble of the Act provides that the Board has been established to protect the interest of the investors in securities and to regulate the development of the securities market. SEBI has issued rules and procedures for registering and regulating the various market participants and intermediaries. These cover brokers, bankers, registrars, portfolio managers, custodians, credit rating agencies, Foreign Institutional Investors, Venture Capital Funds, Mutual Funds and Asset Management Companies. This would be crucial for the promotion of orderly and healthy growth of the securities market.

SEBI has been vested with exclusive powers to regulate the primary market and concurrent powers to regulate the secondary market. The matters concerning issue of capital are primarily governed by the provisions of the Companies Act 1956. In this regard, SEBI's role is to ensure that proper guidelines are followed by the companies and that they provide adequate disclosures in the offer documents to the investors.

The S E B I Act, provides SEBI with the following powers:

a) to regulate the business in stock exchanges;

b) to register and to regulate the working of stock brokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with securities markets in any manner;

c) to register and to regulate the working of collective investment schemes, including mutual funds;

d) to promote and regulate self-regulatory organisations;

e) to prohibit fraudulent and unfair trade practices;

f) to promote investor's education and training of intermediaries;

g) to prohibit insider trading in securities;

h) to regulate substantial acquisition of shares and takeover of companies;

i) to call for information from, to undertake inspection, to conduct enquires and audits of stock exchanges and intermediaries and self-regulatory organisations in the securities markets;

j) to levy fees or other charges for carrying out the purposes of this section;

k) to conduct research for the above purposes;

l) to perform such functions and to exercise such powers under the provisions of the capital issues (Control) Act, 1947 and the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government; and

m) to perform such other functions as may be prescribed.

SEBI's role as a regulator is only to lay down rules and ensure their observance which will automatically result in a healthier and subsequently a speedier development of the capital market in India.

The Government of India strengthened the regulatory powers of the S E B I over capital market intermediaries and companies by an ordinance called the Securities Laws (Amendment) Ordinance 1995, on the 27th January 1995. The ordinance empowered SEBI, to impose monetary penalties on capital market intermediaries and other participants for a range of violations. It gives SEBI, power to issue directions to all concerned parties so as to protect investor interest and to ensure orderly development of the securities market. Besides it has brought the listing agreement under the purview of the SEBI Act.

Popularising dematerialisation (paperless trading), formulating regulations for derivatives, buyback of shares, collective investment schemes and amendments to the takeover regulations of 1992 have been prominent among the landmark policy initiatives adopted by SEBI.

3.4.4 Dhanuka Panel Recommendations

SEBI had appointed the Dhanuka Committee on February 28 1997, to examine areas of deficiency in the SEBI Act 1992, Securities

Control (Regulation) Act, 1956, Depositories Act, 1996 and Companies Act 1956, pertaining to the capital market.

The main principles adopted by the Committee stated that it is essential to expand the scope and arena of legislation in the securities market and to cover several pockets of activity, which have hitherto escaped legislation. Investor protection is of paramount importance.

The securities market being a dynamic entity, all aspects of market regulations cannot be provided by legislation, and considerable flexibility and latitude must be provided to evolve, by delegated legislation in the form of rules, regulations and guidelines. This delegated legislation should have the requisite underpinnings unambiguously expressed for proper implementation and enforcement.

The Committee has recommended that SEBI should be the sole regulatory agency for securities market, including in relation to certain provisions in the Companies Act. Scope of SEBI's powers to issue directions, is extended also to investors or any other person, rather than intermediaries.

Strict provisions have been made for the regulation of issuer, particularly in relation to issue of securities and disclosure standards. Provision has been made for establishment of a Clearing Corporation and the regulation thereof. UTI to be regulated as a mutual fund notwithstanding the provisions of UTI Act, 1963.

3.4.5 Companies Bill, 1997

The Draft Companies Bill has been refined and improved upon and the official version of the Bill has since been introduced in the Rajya Sabha on 14th August 1997. The main objective of re-enacting the Companies Act is to facilitate a healthy growth of the Indian corporate sector under a liberalised and highly competitive environment. The core object of the Companies Bill is to provide effective protection to the different participants to the pursuit of the company's objective.

The Bill has made a clear-cut demarcation of the companies as private limited company, listed public company and unlisted public company. Such a classification would go long way to enable private companies and unlisted public companies to bloom by means of greater degree of self-governance and lesser degree of government regulations.

Listed companies that have to discharge onerous responsibilities towards the investors at large would be regulated by SEBI. SEBI shall have the exclusive power to regulate the raising of capital by listed public companies, and there would be no contradictory or overlapping jurisdiction on investor protection matters and there would be proper redressal of investor grievances.

The Bill seeks to remove some of the investor grievances, strengthen the machinery for taking defaulting companies to task and even propose creation of an Investor Protection Fund coupled with an Investor Education Fund.

The Bill seeks to involve officers such as every Director on the Board, Chief Accounts Officer, Share Transfer Agents, Bankers, Registrars to an issue, Merchant Bankers and Debenture Trustees as "Officers in default" in event of default in compliance with provisions of the Companies Act.

SEBI has been exclusively empowered to deal with public listed companies in matters relating to raising of capital. Investors aggrieved by defaults by companies can now straightaway approach SEBI, which would have the power of prosecution in matters of public listed companies.

3.5. Stock Market Reforms – Recent Developmemts

The Melegam Committee was set up by SEBI in 1995, to recommend a comprehensive reform in the primary market. Y.H.Melegam was the Chairman of the committee.

The recommendations made by the 12 member committee are expected to go a long way in improving the quality of capital issues in India. Issuers are required to disclose meaningful information to help investors take sound decisions.

One of the major proposals has been to do away with projections of results as they are misleading. The committee has recognized that risk is inherent in the equity cult and the investors have to accept this fact.

The flavour of liberalisation and economic reforms have given an enormous thrust to business activities in India. The shift towards a market led economy has evoked a vigorous response from the corporate sector. Aided by a buoyant capital market, the corporate sector was on a capital re-structuring exercise, expanding the equity base.

This development has brought into the main stream millions of new investors. Many of them have entered the field without much knowledge and familiarity with the intricacies of the system and market practices. As also being substantiated by the survey findings, many investors have burned their fingers badly and are scared to have a second look at the primary and secondary markets.

3.5.1. Scream To Screen

The event that marked a complete change in the 123 year history of the stock exchanges in India is the transition from scream to screen based trading. Bombay stock exchange moved from the open outcry system to computerized online trading on March 14, 1995. Trading is done by members and their authorised assistants from their Trader Work Stations (TWS) in their offices, through the BSE On-Line Trading (BOLT) system. BOLT system accepts two-way quotations from jobbers, market and limit orders from client-brokers and matches them according to the matching logic specified in the Business Requirement Specifications (BRS) document for this system. The year

1996-97 has witnessed tremendous changes in the Indian Capital Market. The majority of the stock exchanges have shifted to the screen based on line trading system.

Cochin stock exchange has launched screen based trading system on 17th march 1997. The COLT system (Cochin On Line Trading System) provides transparency in all dealings. Each trade done has an identification number. The time, rate, and the broker with whom the trade was done can be identified.

3.5.2 Euro Issues

As part of globalising the economy, the government undertook two major steps- that of allowing Foreign Institutional Investors (FIIs) to invest in the Indian Capital market and permitting Indian Companies to float their stocks in foreign markets.

Two primary instruments floated by the Indian companies in International markets are Global Depository Receipts (GDRs) and Foreign Currency Convertible Bonds (FCCBs), commonly known as the Euro Issues.

Global Depository Receipt is an instrument issued abroad, listed and traded on foreign stock markets. A GDR is convertible into shares. India established itself in the Euro-markets in 1994. 59 Indian companies have already entered the Euro markets raising $9 billion.

3.5.3 Credit Rating

Credit rating is a simple and easy to understand symbolic indicator of the opinion of a credit rating agency about the risk involved in a borrowing programme of an issuer with reference to the capability of the issuer to repay the debt as per terms of issue. Rating symbols indicate on the one hand the probability of default to be committed by the issuer of the instruments and on the other hand the willingness on the part of the rated issuer to make timely payments as per terms of issue of a particular security. Credit ratings provide an investor with critical information to enable him to take an informed investment decision based on his risk-return preferences. Presently, RBI has approved four credit rating agencies in India as follows:

1. Credit Rating Information Services of India Ltd. (CRISIL)

2. Investment Information and Credit Rating Agency of India Ltd (ICRA).

3. Credit Analysis and Research Ltd (CARE).

4. Duff & Phelps Credit Rating India (Pvt.) Ltd. (DCR is an Indo-US joint venture.)

Ratings are based on an in-depth study of the industry as also on evaluation of the strengths and weaknesses of the company. Once the rating has been accepted by the company, the rating agency continuously monitors the corporate, and if necessary, the rating is changed, upwards or downwards. These help investors to select the appropriate investment opportunities from a large range of options available.

Rated securities bring improvements in capital market and reflect upon its efficient functioning. Trading of rated securities both in primary market as well as in secondary market becomes smooth and frequent with easy marketability and liquidity which benefits all the constituents of the capital market.

3.5.4 Depositories

Depository is an organisation where the securities of a share - holder are held in the electronic form (dematerialised form) at the request of the shareholder through a Depository Participant. Financial Institutions, Banks, Custodians, Stock-brokers etc. can become Participants in the Depository. It minimises the paper work involved with the ownership, trading and transfer of securities.

The National Securities Depository Ltd (NSDL) is an organisation promoted by the IDBI, the UTI and the NSE. It has been registered by SEBI on the 7th June 1996. NSDL levy a nominal service charge on investors using the Depository (7 Paise per Rs.100). NSDL sends statements of records to the investors at regular intervals and at times randomly. So investors can verify the statement with that received from the depository participant.

3.5.5 Inter-Connected Stock Exchange (ISE)

Inter-connectivity of stock exchanges is being established in India. It permits members of one exchange to trade directly with the member of another participating exchange. The inter-market trades would be communicated from the member terminal via the VSAT or leased line to the central system at Mumbai.

The Inter-Connected Stock Exchange of India Ltd. (ISE), located in a new satellite township near Mumbai, will have on-line link-up with 15 regional exchanges. It is proposed that a common clearing bank would be appointed. The mode of collection or payment of money would be through an electronic debit or credit entry.

3.5.6 Derivatives

Derivatives are a key part of the financial system in the modern world. Derivatives are financial contracts, which derive their value off a spot price time-series. The important contract types are futures and options.

Futures markets are like forward markets in terms of basic economics. Future markets are designed to solve the problems of forward markets, like lack of centralisation of trading, liquidity and counter-party risk.

An option is the right, but not the obligation, to buy or sell something at a stated date at a stated price. A 'call option' gives one the right to buy, a 'put option' gives one the right to sell. The key motivation for such instrument is that they are useful in reallocating risk, either across time or among individuals with different risk-bearing preferences.

India is on the thresh-hold of introducing derivatives trading. SEBI had set up the L.C.Gupta committee to develop the regulatory framework for derivatives trading. The committee has already submitted the report. The derivatives committee suggested a phased introduction to derivatives trading, beginning with stock index futures. The panel also laid down the ground rules for a derivatives exchange, to operate as an effective self-regulatory organisation.

Accepted recommendations made by the L.C Gupta Committee on derivatives are the following:

- There should be phased introduction of derivative products with the stock index futures as the starting point for equity derivatives in India.

- Definition of "Securities" under Securities Contracts (Regulation) Act be expanded by declaring derivative contracts based on index of prices of securities and other derivative contracts as securities.

- Existing stock exchanges be permitted to trade derivatives provided they meet the eligibility conditions which would, inter-alia, include adequate infra-structural facilities, online trading and surveillance system and minimum of 50 members opting for derivative trading.

- The derivative market should have a separate Governing Council with representation of trading/clearing members of the derivative segment limited to 40%.

- Initial margin requirements related to the risk of loss on the position and capital adequacy norms shall be prescribed.

- Annual inspection of all the members operating in the derivative segment would be undertaken by the stock exchanges.

- The clearing corporations/house to settle derivative trades would have to meet certain specified eligibility conditions and the clearing corporation/house must interpose itself between both legs of every trade, becoming the legal counter party to both or alternatively provide an unconditional guarantee for settlement of all trades.

- There would be two tier membership ie., the trading member and clearing member and the entry norms for the clearing member would be comparatively more stringent.

- A model Risk Disclosure Document would be prescribed and the Exchange would monitor the broker dealer/client relationship. The sales personnel working in the broker dealer office would need to pass a certification programme.

- Corporate clients/financial institutions/Mutual Funds should be allowed to trade derivatives only if and to the extent authorised by their Board of Directors/ Trustees.

- The issue of accounting and disclosure norms for derivatives be taken up with the Institute of Chartered Accountants of India so that proper accounting disclosures are made in the annual reports of the corporates and others.

3.6 Conclusion

Although the first stock exchange in India was established in 1875, it is only since the 1970s that the stock exchanges have had a reasonably significant role in the development of Indian Economy. The phenomenon of corporate securitisation and the real activisation of the exchanges has attracted the small investors to the capital market. Besides, the entrance of the mutual funds and Foreign Institutional Investors has resulted in a complete transformation of the securities market. Rash speculation in stocks and shares of the early 90s and the unprecedented bullish fervour which followed, ultimately led to the securities scam of 1992. These developments and the phenomenal growth in the stock markets prompted the policy makers to introduce stringent measures in improving the operations of these markets. SEBI has taken several steps for widening and deepening different segments of the market and for promoting investor protection and market development. Despite the bearish trend, the capital market in India is on the move.

The 150 years of stock broking in India is a saga of historic events. The capital markets in India have gone trough a metamorphosis, especially since the introduction of libralisation in the eighties. Capital market is one of the fields where the nation has effectively introduced the spectacular changes in science and technology. Screen based trading and dematerialised scrips have changed the phase of the capital markets in India. Now India is on the threshold of introducing trade in derivatives.