Indian Capital Market : An Overview

Aman Srivastava
Assistant Professor, NDIM

Evolution

This paper reviews the evolution of the Indian capital market and describes its current status. It shows how the Indian market has gone through a process of modernisation and structural transformation during the last few years. Indian Stock Markets are one of the oldest in Asia. Its history dates back to nearly 200 years ago. The earliest records of security dealings in India are meager and obscure. The East India Company was the dominant institution in those days and business in its loan securities used to be transacted towards the close of the eighteenth century. By 1830's business on corporate stocks and shares in Bank and Cotton presses took place in Bombay. Though the trading list was broader in 1839, there were only half a dozen brokers recognized by banks and merchants during 1840 and 1850.The 1850's witnessed a rapid development of commercial enterprise and brokerage business attracted many men into the field and by 1860 the number of brokers increased to 60.In 1860-61 the American Civil War broke out and cotton supply from United States of Europe was stopped; thus, the 'Share Mania' in India begun. The number of brokers increased to about 200 to 250. However, at the end of the American Civil War, in 1865, a disastrous slump began (for example, Bank of Bombay Share which had touched Rs 2850 could only be sold at Rs. 87).At the end of the American Civil War, the brokers who thrived out of Civil War in 1874, found a place in a street (now appropriately called as Dalal Street) where they would conveniently assemble and transact business. In 1887, they formally established in Bombay, the "Native Share and Stock Brokers' Association" (which is alternatively known as " The Stock Exchange "). In 1895, the Stock Exchange acquired a premise in the same street and it was inaugurated in 1899. Thus, the Stock Exchange at Bombay was consolidated.

Indian Stock Exchanges - Historical Growth

The Second World War broke out in 1939. It gave a sharp boom which was followed by a slump. But, in 1943, the situation changed radically, when India was fully mobilized as a supply base.

On account of the restrictive controls on cotton, bullion, seeds and other commodities, those dealing in them found in the stock market as the only outlet for their activities. They were anxious to join the trade and their number was swelled by numerous others. Many new associations were constituted for the purpose and Stock Exchanges in all parts of the country were floated.

The Uttar Pradesh Stock Exchange Limited (1940), Nagpur Stock Exchange Limited (1940) and Hyderabad Stock Exchange Limited (1944) were incorporated.

In Delhi two stock exchanges - Delhi Stock and Share Brokers' Association Limited and the Delhi Stocks and Shares Exchange Limited - were floated and later in June 1947, amalgamated into the Delhi Stock Exchnage Association Limited.

India boasts of the oldest stock exchange in Asia — the Bombay Stock Exchange is 125 years old. There are 23 recognised exchanges spread across the country, but a process of consolidation is now under way. Many of the regional stock exchanges have started aligning themselves with one or both of the two large exchanges (the Bombay Stock Exchange and the National Stock Exchange) both of which have VSAT networks that give them a nation wide reach. The National Stock Exchange is an unlisted for-profit company set up by some of the leading financial institutions of India. Most of the remaining stock exchanges are broker-owned (mutual) organisations, but the Bombay Stock Exchange is actively considering demutualisation. The Securities and Exchange Board of India (SEBI), the apex regulator of the capital market has regulations that mandate a minimum number of outside directors on the governing board and provide greater autonomy to the professional executives in the day-to-day running of the exchange. Ahmedabad gained importance next to Bombay with respect to cotton textile industry. After 1880, many mills originated from Ahmedabad and rapidly forged ahead. As new mills were floated, the need for a Stock Exchange at Ahmedabad was realised and in 1894 the brokers formed "The Ahmedabad Share and Stock Brokers' Association".What the cotton textile industry was to Bombay and Ahmedabad, the jute industry was to Calcutta. Also tea and coal industries were the other major industrial groups in Calcutta. After the Share Mania in 1861-65, in the 1870's there was a sharp boom in jute shares, which was followed by a boom in tea shares in the 1880's and 1890's; and a coal boom between 1904 and 1908. On June 1908, some leading brokers formed "The Calcutta Stock Exchange Association".In the beginning of the twentieth century, the industrial revolution was on the way in India with the Swadeshi Movement; and with the inauguration of the Tata Iron and Steel Company Limited in 1907, an important stage in industrial advancement under Indian enterprise was reached.Indian cotton and jute textiles, steel, sugar, paper and flour mills and all companies generally enjoyed phenomenal prosperity, due to the First World War.In 1920, the then demure city of Madras had the maiden thrill of a stock exchange functioning in its midst, under the name and style of "The Madras Stock Exchange" with 100 members. However, when boom faded, the number of members stood reduced from 100 to 3, by 1923, and so it went out of existence.

In 1935, the stock market activity improved, especially in South India where there was a rapid increase in the number of textile mills and many plantation companies were floated. In 1937, a stock exchange was once again organized in Madras - Madras Stock Exchange Association (Pvt) Limited. (In 1957 the name was changed to Madras Stock Exchange Limited).

Lahore Stock Exchange was formed in 1934 and it had a brief life. It was merged with the Punjab Stock Exchange Limited, which was incorporated in 1936.

Post-independence Scenario

Most of the exchanges suffered almost a total eclipse during depression. Lahore Exchange was closed during partition of the country and later migrated to Delhi and merged with Delhi Stock Exchange.

Bangalore Stock Exchange Limited was registered in 1957 and recognized in 1963.

Most of the other exchanges languished till 1957 when they applied to the Central Government for recognition under the Securities Contracts (Regulation) Act, 1956. Only Bombay, Calcutta, Madras, Ahmedabad, Delhi, Hyderabad and Indore, the well established exchanges, were recognized under the Act. Some of the members of the other Associations were required to be admitted by the recognized stock exchanges on a concessional basis, but acting on the principle of unitary control, all these pseudo stock exchanges were refused recognition by the Government of India and they thereupon ceased to function.

Thus, during early sixties there were eight recognized stock exchanges in India (mentioned above). The number virtually remained unchanged, for nearly two decades. During eighties, however, many stock exchanges were established: Cochin Stock Exchange (1980), Uttar Pradesh Stock Exchange Association Limited (at Kanpur, 1982), and Pune Stock Exchange Limited (1982), Ludhiana Stock Exchange Association Limited (1983), Gauhati Stock Exchange Limited (1984), Kanara Stock Exchange Limited (at Mangalore, 1985), Magadh Stock Exchange Association (at Patna, 1986), Jaipur Stock Exchange Limited (1989), Bhubaneswar Stock Exchange Association Limited (1989), Saurashtra Kutch Stock Exchange Limited (at Rajkot, 1989), Vadodara Stock Exchange Limited (at Baroda, 1990) and recently established exchanges - Coimbatore and Meerut. Thus, at present, there are totally twenty one recognized stock exchanges in India excluding the Over The Counter Exchange of India Limited (OTCEI) and the National Stock Exchange of India Limited (NSEIL).

Growth Pattern

The Table given below portrays the overall growth pattern of Indian stock markets since independence. It is quite evident from the Table that Indian stock markets have not only grown just in number of exchanges, but also in number of listed companies and in capital of listed companies. The remarkable growth after 1985 can be clearly seen from the Table, and this was due to the favouring government policies towards security market industry.

	1961*	1971*	1980*	1991	2001	2002	2003
No of stock exchanges	7	8	9	22	23	23	23
No of listed companies	1203	1599	2265	6229	9871	9644	9413
Market Capitalization (Rs billion)	12	27	68	1103	11926	7493	6319
* end December the stock exchange Mumbai only							
(Source: BSE & NSE)							

Trading Pattern of the Indian Stock Market

India's stock exchanges are fully computerised order driven or order-cum-quote driven systems. The country has made rapid strides towards a dematerialised trading environment on the basis of a competing depositories model. Investors have the choice of holding their stocks in physical or dematerialised form, but trading in the exchanges is in mandatory dematerialised mode in most important stocks. As of October 2000, about 98per cent of the trading in the stock exchanges is in dematerialised mode.

India has put in place a regulatory regime for internet trading of stocks. A large number of online brokers have started operations. More brokers are expected to follow when the exchanges put in place an ASP (Application Service Provider) model for online trading software. However, currently, the level of penetration of online trading is extremely small.

The stock exchanges currently run two parallel settlement systems. Practically all the trading takes place in the account period settlement system in which all trades during a weekly account period are netted off and the net obligations are settled five business days after the end of the period. The other unpopular system is that of rolling settlements where trades of each day are settled on a T+5 basis. SEBI is currently working on mandatorily shifting all stocks in a phased manner to the rolling settlement system. Further improvements in the settlement system to T+3 or beyond would have to wait for improvements in the payment system.

However, account period settlement does not give rise to significant systemic risks in India because of stringent end of day and intra-day margining systems. Put simply, the weekly settlement is regarded as akin to a one-week futures contract, and the systemic risk is taken care of by using futures style margining. The exchange imposes daily mark to market and initial margins on the brokers to eliminate settlement risk. Exchanges also have clearing houses to guarantee settlements on the exchange. As a result, there have been no settlement failures in the principal stock exchanges during the last five years.

Over The Counter Exchange of India (OTCEI)

The traditional trading mechanism prevailed in the Indian stock markets gave way to many functional inefficiencies, such as, absence of liquidity, lack of transparency, unduly long settlement periods and benami transactions, which affected the small investors to a great extent. To provide improved services to investors, the country's first ringless, scripless, electronic stock exchange - OTCEI - was created in 1992 by country's premier financial institutions - Unit Trust of India, Industrial Credit and Investment Corporation of India, Industrial Development Bank of India, SBI Capital Markets, Industrial Finance Corporation of India, General Insurance Corporation and its subsidiaries and CanBank Financial Services.

Trading at OTCEI is done over the centres spread across the country. Securities traded on the OTCEI are classified into:

- Listed Securities - The shares and debentures of the companies listed on the OTC can be bought or sold at any OTC counter all over the country and they should not be listed anywhere else
- Permitted Securities - Certain shares and debentures listed on other exchanges and units of mutual funds are allowed to be traded
- Initiated debentures - Any equity holding atleast one lakh debentures of a particular scrip can offer them for trading on the OTC.

OTC has a unique feature of trading compared to other traditional exchanges. That is, certificates of listed securities and initiated debentures are not traded at OTC. The original certificate will be safely with the custodian. But, a counter receipt is generated out at the counter which substitutes the share certificate and is used for all transactions.

In the case of permitted securities, the system is similar to a traditional stock exchange. The difference is that the delivery and payment procedure will be completed within 14 days.

Compared to the traditional Exchanges, OTC Exchange network has the following advantages:

- OTCEI has widely dispersed trading mechanism across the country which provides greater liquidity and lesser risk of intermediary charges.
- Greater transparency and accuracy of prices is obtained due to the screen-based scripless trading.
- Since the exact price of the transaction is shown on the computer screen, the investor gets to know the exact price at which s/he is trading.
- Faster settlement and transfer process compared to other exchanges.
- In the case of an OTC issue (new issue), the allotment procedure is completed in a month and trading commences after a month of the issue closure, whereas it takes a longer period for the same with respect to other exchanges.

Thus, with the superior trading mechanism coupled with information transparency investors are gradually becoming aware of the manifold advantages of the OTCEI.

National Stock Exchange (NSE)

With the liberalization of the Indian economy, it was found inevitable to lift the Indian stock market trading system on par with the international standards. On the basis of the recommendations of high powered Pherwani Committee, the National Stock Exchange was incorporated in 1992 by Industrial Development Bank of India, Industrial Credit and Investment Corporation of India, Industrial Finance Corporation of India, all Insurance Corporations, selected commercial banks and others.

Trading at NSE can be classified under two broad categories:

(a) Wholesale debt market and

(b) Capital market.

Wholesale debt market operations are similar to money market operations - institutions and corporate bodies enter into high value transactions in financial instruments such as government securities, treasury bills, public sector unit bonds, commercial paper, certificate of deposit, etc.

There are two kinds of players in NSE:

(a) trading members and

(b) participants.

Recognized members of NSE are called trading members who trade on behalf of themselves and their clients. Participants include trading members and large players like banks who take direct settlement responsibility.

Trading at NSE takes place through a fully automated screen-based trading mechanism which adopts the principle of an order-driven market. Trading members can stay at their offices and execute the trading, since they are linked through a communication network. The prices at which the buyer and seller are willing to transact will appear on the screen. When the prices match the transaction will be completed and a confirmation slip will be printed at the office of the trading member.

NSE has several advantages over the traditional trading exchanges. They are as follows:

- NSE brings an integrated stock market trading network across the nation.
- Investors can trade at the same price from anywhere in the country since inter-market operations are streamlined coupled with the countrywide access to the securities.
- Delays in communication, late payments and the malpractice's prevailing in the traditional trading mechanism can be done away with greater operational efficiency and informational transparency in the stock market operations, with the support of total computerized network.

Unless stock markets provide professionalised service, small investors and foreign investors will not be interested in capital market operations. And capital market being one of the major source of long-term finance for industrial projects, India cannot afford to damage the capital market path. In this regard NSE gains vital importance in the Indian capital market system.

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