

# Securities Markets in India Opportunities and Challenges



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A unique feature of Indian securities markets is the wide range of reforms that it experienced over the last decade. While the significance and importance of the stock markets witnessed sizeable growth in the aftermath of the introduction of a broad range of economic reforms, beginning 1991, the most crucial measures of market development were taken in

the last three years. In contrast to the earlier reforms, the recent measures of reforms mostly dealt with such issues such as governance of stock exchanges, market integration, securities settlement, surveillance and risk management, operational processes, and above all investor safety.

The rapid changes in the governance structures made administration of the stock exchanges more autonomous and accountable with more of independent directors involved in the overall governance and policy making of the stock exchanges. Stock exchanges now are headed by chief executive officers drawn from the professional and the boards now consist of a right balance and mix of professionals drawn from outside and those with industry experience and domain knowledge.

These reforms are evident nowhere more than in BSE, the Stock Exchange, Mumbai. The Chairman, who is non-executive chairman, is a leading personality or professional and independent directors form more than 50 percent of the total board strength. Policy and key decision making is committee driven with experts from various related fields such as technology, finance, economy, academia inducted into these committees to provide expertise and assistance. A formal code of conduct drawn specifically governs the conduct of the members of the board and the senior members of the management and a code of ethics monitors any conflict of interest. Internal audit has been strengthened and so as compliance. Separate cells for compliance and internal audit are envisaged to strengthen and streamline the conduct of business in tune with emerging regulatory norms and policy directions.

Surveillance and risk management became the major benchmarks for operations for the stock exchanges. Efficient risk management procedures and practices

enabled the stock exchanges to overcome the challenges of growing volatility of the markets as also extreme incidents such as that of May 17<sup>th</sup> 2004, when circuit breakers were breached twice during the day and the markets fell by about 12 percent. A great amount of initiatives at the exchanges level are being taken to strengthen surveillance, market watch, and also explore possibilities for integrated surveillance across the stock exchanges which could result in better safety and integrity of the stock markets. BSE has taken lead in developing the surveillance function to international standards and it is perhaps one of the very few stock exchanges in the world to obtain ISO certification for its surveillance function.

Securities Settlement is another major aspect of India's achievement that reflects benchmarking India to international securities markets. India is perhaps one of the few countries to have T+2 securities settlement system and the most interesting aspect of it much of the advances in the securities settlement have taken place in the last five to six years. India currently stands prominent among the emerging stock markets in regard to the faster cycle of securities settlement and is now gearing to move ahead towards T+1 cycle that would make it comparable to even the best of the mature markets. Introduction of Straight Through Processing from July 2004 enabled it to enhance the operational efficiency and introduction of Electronic Contract Notes and Digital Signatures will harness the technology prowess to speed up the operations.

## Bench Marking Stock Exchanges: BSE

Particulars	BSE
Governance	<i>Predominantly independent directors, a code of conduct institutionalized, a quarterly disclosure mandatory for senior management team, a code of ethics monitors any conflict of interest, committee driven decision making, professional management lead by a chief executive officer, a fair balance and mix of independent professionals and industry representatives</i>
Securities Settlement	<i>T+2, Clearing and Settlement Department ISO certified</i>
Risk Management	<i>Very low rate of defaults. In the last seven years only two defaults</i>
Surveillance	<i>Working towards integrated surveillance. BSE Surveillance is ISO certified</i>

Product Range	<i>A wide range of products consisting of trading in equities, whole sale debt, government debt, corporate debt, retail debt segment, index futures and options, stock futures and options, Spice – Exchange Traded Fund in association with ICICI Prudential Asset Management, Real time data, capital market training and certification, publications etc.,</i>
Service Quality	<i>Most preferred exchange in India for new listings. Exclusive services for corporates to care of monitoring of listing norms and other regulatory compliance; an account manager concept for service of requirements of members done through a separate and exclusive Membership Services Dept; Investor Services Dept for conducting investor awareness programmes and also implement investor grievance redressal practices and procedures.</i>
Listing Services	<i>Largest number of listed companies for any exchange in the world. A separate listing procedures for small companies, Pursuing integration of smaller and regional exchanges through a model called “IndoNext”</i>
Knowledge Management	<i>Has perhaps the largest facility for capital market training for any stock exchange in the emerging markets. Offers 40 courses and conducts about 150 programmes a year that are attended by about 5000 participants from India and a dozen countries from South Asia, Central Asia, Africa and Eastern Europe. Has extensive range of publications on various aspects of the functioning of the securities markets.</i>
Investor Services	<i>Real time corporate announcements, information through website: <a href="http://www.bseindia.com">www.bseindia.com</a>; compensation to investors upto Rs.1 million in case of default proved valid; nationwide investor awareness campaigns, investor services centers in major</i>

	<i>centers in India to attend to grievance redressal and bring in more awareness, an exclusive center for imparting investor awareness and research, assisting investor associations and promoting a number of programmes to promote and protect the interests of investors.</i>
Technology	<i>Trading System, BSE Online Trading (BOLT) is fault tolerant, scalable architecture that has a capacity of 4 million trades a day with response time of less than half a second. Trader Work Stations located in more than 400 cities in India.</i>
Financial Strength	<i>A zero debt organization with robust reserves and net worth</i>
Indexing	<i>Offers a large number of benchmark and sectoral indices. SENSEX is the popular benchmark index known worldwide and is constructed on the basis of free float methodology, which once again is the first benchmark index in India to be constructed on the basis of the free float.</i>
Looking Ahead	<i>A demutualised and corporatised entity, diversification of business, creating data bases, value addition to the products and services, acquire global competitiveness, emerge as a knowledge management leader in Asia, harness strengths of domestic economy to emerge as an influential institution in international securities industry.</i>

The product range too expanded sizeably covering equities, debt, derivatives and exchange traded funds. A recent study by the World Federation of Extended Exchange Services revealed that vertical integration across the exchange functions is being observed in many stock exchanges and they are performing more business activities than other service providers. In India stock exchanges are providing a wide spectrum of products and services based on their prowess in trading platforms, technology, information etc,

One major impact of the three years of reform is the dramatic changes in the micro market structure. The securities market architecture in India is wide and large with an extensive institutional framework and availability of financial instruments. The challenge of

creating adequate depth in each of these institutions and instruments is now engaging the attention and priority of the market participants. In this context, it could be said that while the last few years of reforms were centered around enhancing the scope of the infrastructure the priority for the next few years would be developing the depth of it.

#### **Indian Securities Markets : An Overview**

One of the most dynamic, modern, growing and efficient stock markets in the world  
 Two national level stock exchanges and several regional stock exchanges  
 Fully electronic trading platforms and screen based trading  
 Nationwide network covering more than 400 cities in India  
 T+2 Securities Settlement, Straight Through Processing, Electronic Contract Notes and Digital Signatures  
 Almost all trades are settled in dematerialized form  
 Trade Guarantee and Customer Protection Funds  
 Two national level depositories; NSDL and CDSL  
 Presence of around 600 Foreign Institutional Investors with a cumulative net inflow of around US\$ 27 billion  
 Wide product range including equities, debt, derivatives, exchange traded funds  
 The fastest growing market for the equity derivatives  
 Internet Trading Platforms  
 Dual fungibility of shares; ADRs and GDRs  
 Strict monitoring of disclosure and corporate governance norms  
 Electronic Data Information Filing and Retrieval System (EDIFAR) for filing corporate information  
 Central Listing Authority  
 Corporate Governance Rating  
 Indo-next through consolidation of regional stock exchanges

*Source : BSE Annual Capital Market Review*

The current strength offers securities markets in India a number of opportunities to consolidate the gains further and also expand the realm of influence beyond India. In several areas, India has built up rich domain knowledge which could be leveraged to position as a leading provider of a wide range of strategies and solutions for growth and development of securities markets in emerging and transition economies. A few of these include;

**Technology** : Indian securities market currently has the state of the art technology in all aspects of the operations of the stock exchanges. Huge investments are made by the participants and service providers in managing the technology which could provide them with ready-made solutions for stock exchanges in several emerging and transition countries, which are in the process of developing local securities markets.

For instance the trading platform models of BSE are adopted by a few countries in the Middle East and South Asia and several others are looking at attractive options in this regard.

**Knowledge Management** : Indian securities markets were able to establish and create an impressive capacity in knowledge management activities encompassing, training, skill development, financial certification, information dissemination and publications. Very few stock exchanges in the world have the type of infrastructure and intensity of activity in the knowledge management as Indian stock exchanges have. For instance, BSE has an extensive securities market training facility that currently offers 40 courses, conducts about 150 programmes that are attended by over 5000 participants a year. Participants from a number of countries attend these programmes. Indian securities market could harness this advantage and expertise to expand their reach of advice and influence in a number of developing economies

**Equity Culture**: India has about 25 million investors which is just a fraction of economically active population and a small portion of those holding the bank deposits. A vast country with varied regions and growing middle class provides exciting opportunity for the securities markets to penetrate and cultivate and develop equity culture in India. Given the potential for the growth of securities markets, stock exchanges could look forward for a promising period ahead. However, realizing the potential is an equally challenging task that need to be given due focus and attention.

**International Interest**: Though India is among the top ten recipients of the foreign direct investment and foreign institutional investment, volume wise a great scope exists for sizeable improvement. Being one of the biggest markets, the flows to India on both these respects could be much larger than what has been the experience so far. Indian securities market could provide greater visibility about the standards that are achieved and the benchmarks that are met to attract greater interest from the international community both in terms of direct investment and portfolio flows

While opportunities are abundant, equally daunting are the challenges and tough tasks. The first and foremost is creating confidence in the securities markets. For instance, in the financial assets held by the individuals, the share of shares and debentures has steeply fallen from about 13 percent in the early 1990s to less than 4 per cent now. Two to three major upheavals in the stock markets in the last decade have severely dented the confidence of the investors on the stock markets. Apart from creating more awareness, it is important that the conduct of the market participants is monitored with greater vigil and they be made responsible and accountable for lapses with severe penalties and punishments. In a fragile market such as

finance, confidence is of paramount importance and the endeavours towards these need to be further strengthened.

Similarly for the market participants to operate successfully in volatile markets, it is imperative for them to have strong capital base. In banking sector, capital adequacy norms have been in place for about a decade now and in securities markets too, several countries have already prescriptions in place for desirable and required levels of capital adequacy of the market participants. Consolidation of brokerages leading to the emergence of brokerage institutions with larger size is also a worldwide trend.. Investment in technology becomes a priority, which only well capitalized entities could undertake smoothly and swiftly. The cost of regulation also is increasing which makes smaller brokerages difficult to sustain over a longer period. This does not mean that smaller brokerages should not continue, but to emphasise that the operational environment is moving towards large sized brokerages and those who do not have size should be prepared to equip themselves with some niche areas of business that could provide them with an advantage and opportunity to sustain.

In the Indian context, a large number of companies are listed but only a few are actively traded. There is a scope for promoting independent research that could study a large number of companies and provide them with performance profiles to the investors on investment opportunities. These reports could only highlight the features of the performance of the respective companies with out any recommendation attached to it. Such research could help investors in looking at newer opportunities that could enhance the performance of their portfolio. BSE, in the interest of the investors is conducting a pilot exercise on independent stock research. Once found useful, such an exercise could provide extremely useful information to the investors.

As the market grows, the additions to the market infrastructure should be a continuous exercise. Underlining this importance, a task force of the Securities Exchange Board of India is currently looking at the infrastructure development requirements of the Indian securities markets and this exercise could prove extremely relevant to upgrade and expand the infrastructure which would be crucial for development of securities markets in the future.

The 1990s have been remarkable for the stock exchanges world wide. Between 1990 and 2000, the equity market capitalization of the world stock exchanges rose from \$11 trillion to \$35 trillion and, Turnover value from \$5 trillion to \$56 trillion. Revenues of the stock exchanges worldwide too have grown impressively from about \$2 billion in 1991 to about \$8 billion in 2000. The last three years, however have been of concern to the stock exchanges in respect of their

business. Share Turnover value decreased from the peak of \$56 billion in the year 2000 to about \$33 billion in 2000, impacting the revenues of the stock exchanges. Since stock exchanges, as public equity capital markets are imposing strict norms and entry conditions that are making corporate listing and monitoring of compliance norms stringent, private equity markets began to bypass the traditional stock exchanges, which is emerging as a major challenges for the stock exchanges. India too is experiencing these pressures, but it could overcome because of the prospects for growth which still appear very attractive.

India has a unique combination of features that could propel the growth of the securities markets : a policy that supports the growth of the markets; a regulation that is keen on enhancing the quality of functioning of the markets, an institutional framework that adopts best practices and benchmarks, a base of market intermediaries which are skillful, innovative with capacity for assuming greater risk and managing it successfully, investor base keenly looking for safe and secure investment opportunities etc., Harnessing each others strengths and advantages would surely make India , a winner in the global securities markets.

**Market Capitalization as a % of GDP of**

