# CHAPTER 1

# AN OVERVIEW OF THE INDIAN SECURITIES MARKET

## 1.1 Market Segments

Securities markets provide a channel for allocation of savings to those who have a productive need for them. The securities market has two interdependent and inseparable segments: (i) primary market and (ii) secondary market.

### 1.1.1 Primary Market

Primary market provides an opportunity to the issuers of securities, both Government and corporations, to raise resources to meet their requirements of investment. Securities, in the form of equity or debt, can be issued in domestic/international markets at face value, discount or premium.

The primary market issuance is done either through public issues or private placement. Under Companies Act, 1956, an issue is referred as public if it results in allotment of securities to 50 investors or more. However, when the issuer makes an issue of securities to a select group of persons not exceeding 49 and which is neither a rights issue nor a public issue it is called a private placement.

### 1.1.2 Secondary Market

Secondary market refers to a market where securities are traded after being offered to the public in the primary market or listed on the Stock Exchange. Secondary market comprises of equity, derivatives and the debt markets. The secondary market is operated through two mediums, namely, the Over-the-Counter (OTC) market and the Exchange-Traded market. OTC markets are informal markets where trades are negotiated.

## 1.2 Key Indicators of Securities Market

### 1.2.1 Index

An Index is used to give information about the price movements of products in the financial, commodities or any other markets. Stock market indices are meant to capture the overall behaviour of the equity markets. The stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market. The blue chip index of NSE is CNX Nifty.

### 1.2.2 Market Capitalisation

Market capitalisation is defined as value of all listed shares on the country’s exchanges.

It is computed on a daily basis. Market capitalisation of a particular company on a particular day can be computed as product of the number of shares outstanding and the closing price of the share. Here the number of outstanding shares refers to the issue size of the stock.

Market Capitalisation = Closing price of share * Number of outstanding shares

Similarly, to compute the market capitalization of all companies listed on an Exchange we aggregate the market capitalization of all the companies traded on the Exchange.

### 1.2.3 Market Capitalisation Ratio

The market capitalization ratio is defined as market capitalization of stocks divided by GDP. It is used as a measure of stock market size.

### 1.2.4 Turnover

Turnover for a share is computed by multiplying the traded quantity with the price at which the trade takes place. Similarly, to compute the turnover of the companies listed at the Exchange we aggregate the traded value of all the companies traded on the Exchange.

### 1.2.5 Turnover Ratio

The turnover ratio is defined as the total value of shares traded on a country's stock Exchange for a particular period divided by market capitalization at the end of the period. It is used as a measure of trading activity or liquidity in the stock markets.

Turnover Ratio = Turnover at Exchange / Market Capitalisation at Exchange

## 1.3 Products and Participants

### 1.3.1 Products

Financial markets facilitate reallocation of savings from savers to entrepreneurs. Savings are linked to investments by a variety of intermediaries through a range of complex financial products called "securities". Under the Securities Contracts (Regulation) Act [SC(R)A], 1956, "securities" include (i) shares, bonds, scrips, stocks or other marketable securities of like nature in or of any incorporate company or body corporate, (ii) government securities, (iii) derivatives of securities, (iv) units of collective investment scheme, (v) interest and rights in securities, and security receipt or any other instruments so declared by the central government. Broadly, securities can be of three types - equities, debt securities and derivatives.

### 1.3.2 Participants

The securities market has essentially three categories of participants (i) the investors, (ii) the issuers, (iii) the intermediaries (Figure 1.1). These participants are regulated by the Securities and Exchange Board of India (SEBI), Reserve Bank of India (RBI), Ministry of Corporate Affairs (MCA) and the Department of Economic Affairs (DEA) of the Ministry of Finance.

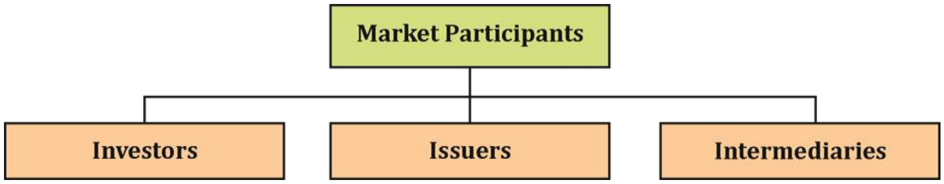


Figure 1.1 Market Participants

Table 1.1 below provides the information on Market participants in India.

**Table: 1.1 Market Participants in India**

| **Market Participants** |
|---|
| Investors |
| Individual Investors |
| Corporate Investors |
| Foreign Venture Capital Investors |
| FIIs |
| Depositories |
| Stock Exchanges |
| With Equities Trading |
| With Debt Market Trading |
| With Derivative Trading |
| With Currency Derivatives |
| Brokers |
| Corporate Brokers |
| Sub-brokers |
| Portfolio Managers |
| Custodians |
| Registrars to an issue & Share Transfer Agents |
| Primary Dealers |
| Merchant Bankers |

| |
|---|
| Bankers to an Issue |
| Debenture Trustees |
| Underwriters |
| Venture Capital Funds |
| Mutual Funds |
| Collective Investment Schemes |

## 1.4 Market Segments and their Products

The Exchange (NSE) provides trading in four different segments - Wholesale Debt Market, Capital Market, Futures and Options and Currency Derivatives Segment as depicted in the figure 1.2 below.

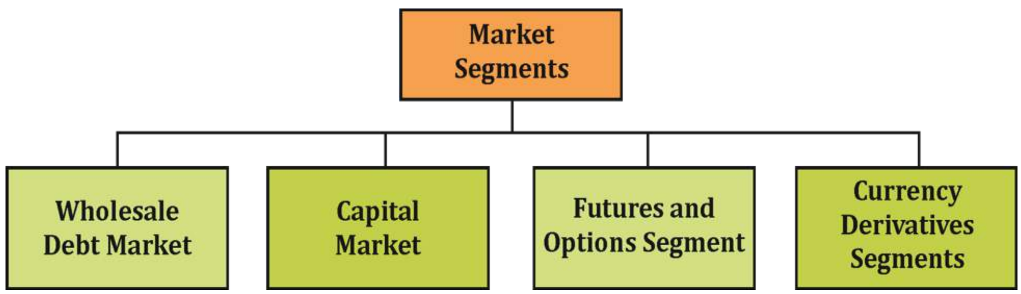


Figure 1.2: Market Segments

**(i) Wholesale Debt Market (WDM) Segment:** This segment at NSE commenced its operations in June 1994. It provides the trading platform for wide range of debt securities which includes State and Central Government securities, T-Bills, PSU Bonds, Corporate debentures, Commercial Papers, Certificate of Deposits etc.

**(ii) Capital Market (CM) Segment:** This segment at NSE commenced its operations in November 1994. It offers a fully automated screen based trading system, known as the National Exchange for Automated Trading (NEAT) system. Various types of securities e.g. equity shares, warrants, debentures etc. are traded on this system.

**(iii) Futures & Options (F&O) Segment:** This segment provides trading in derivatives instruments like index futures, index options, stock options, and stock futures, and commenced its operations at NSE in June 2000.

**(iv) Currency Derivatives Segment (CDS) Segment:** This segment at NSE commenced its operations on August 29, 2008, with the launch of currency futures trading in US Dollar-Indian Rupee (USD-INR). Trading in other currency pairs like Euro-INR, Pound Sterling-INR and Japanese Yen-INR was further made available for trading in February 2010. 'Interest rate futures' was another product made available for trading on this segment with effect from August 31, 2009.

## 1.5 Reforms in Indian Securities Markets

Over a period, the Indian securities market has undergone remarkable changes and grown exponentially, particularly in terms of resource mobilisation, intermediaries, the number of listed stocks, market capitalisation, turnover and investor population. The following paragraphs list the principal reform measures undertaken since 1992.

**Creation of Market Regulator:** Securities and Exchange Board of India (SEBI), the securities market regulator in India, was established under SEBI Act 1992, with the main objective and responsibility for (i) protecting the interests of investors in securities, (ii) promoting the development of the securities market, and (iii) regulating the securities market.

**Screen Based Trading:** Prior to setting up of NSE, the trading on stock exchanges in India was based on an open outcry system. The system was inefficient and time consuming because of its inability to provide immediate matching or recording of trades. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully automated screen based trading system (SBTS) on the CM segment on November 3, 1994.

**Reduction of Trading Cycle:** Earlier, the trading cycle for stocks, based on type of securities, used to vary between 14 days to 30 days and the settlement involved another fortnight. The Exchanges, however, continued to have different weekly trading cycles, which enabled shifting of positions from one Exchange to another. It was made mandatory for all Exchanges to follow a uniform weekly trading cycle in respect of scrips not under rolling settlement. In December 2001, all scrips were moved to rolling settlement and the settlement period was reduced progressively from T+5 to T+3 days. From April 2003 onwards, T+2 days settlement cycle is being followed.

**Equity Derivatives Trading:** In order to assist market participants in managing risks better through hedging, speculation and arbitrage, SC(R) A was amended in 1995 to lift the ban on options in securities. Trading in derivatives, however, took off in 2000 with index futures after suitable legal and regulatory framework was put in place. The market presently offers index futures, index options, single stock futures and single stock options.

**Demutualisation:** Historically, stock exchanges were owned, controlled and managed by the brokers. In case of disputes, integrity of the stock exchange suffered. NSE, however, was set up with a pure demutualised governance structure, having ownership, management and trading with three different sets of people. Currently, all the stock exchanges in India have a demutualised set up.

**Dematerialisation:** As discussed before, the old settlement system was inefficient due to (i) the time lag for settlement and (ii) the physical movement of paper-based securities. To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed and accuracy. There are two depositories in India, viz. NSDL and CDSL. They have been set up to provide instantaneous electronic transfer of securities. Demat (Dematerialised) settlement has eliminated the bad deliveries and associated problems. To prevent physical certificates from sneaking into circulation, it has been made mandatory for all newly issued securities to be compulsorily traded in dematerialised form. Now, the public listed companies making IPO of any security for ₹ 10 crore or more have to make the IPO only in dematerialised form.

**Clearing Corporation:** The anonymous electronic order book ushered in by the NSE did not permit members to assess credit risk of the counter-party and thus necessitated some innovation in this area. To address this concern, NSE had set up the first clearing corporation, viz. National Securities Clearing Corporation Ltd. (NSCCL), which commenced its operations in April 1996.

**Investor Protection:** In order to protect the interest of the investors and promote awareness, the Central Government (Ministry of Corporate Affairs[1]) established the Investor Education and Protection Fund (IEPF) in October 2001. With the similar objectives, the Exchanges and SEBI also maintain investor protection funds to take care of investor claims. SEBI and the stock exchanges have also set up investor grievance / service cells for redress of investor grievance. All these agencies and investor associations also organise investor education and awareness programmes.

**Globalisation:** Indian companies have been permitted to raise resources overseas through issue of ADRs, GDRs, FCCBs and ECBs. Further, FIIs have been permitted to invest in all types of securities, including government securities and tap the domestic market. The investments by FIIs enjoy full capital account convertibility. They can invest in a company under portfolio investment route upto 24% of the paid up capital of the company. This can be increased up to the sectoral cap/statutory ceiling, as applicable to the Indian companies concerned, by passing a resolution of its Board of Directors followed by a special resolution to that effect by its general body. The Indian stock exchanges have been permitted to set up trading terminals abroad. The trading platform of Indian exchanges is now accessible through the Internet from anywhere in the world. RBI permitted two-way fungibility for ADRs / GDRs, which means that the investors (foreign institutional or domestic) who hold ADRs / GDRs can cancel them with the depository and sell the underlying shares in the market.

**Launch of India VIX[2]:** Volatility index is a measure of market's expectation of volatility over the near term. It measures the amount by which an underlying Index is expected to fluctuate in the near term, based on the order book of the underlying index options. India's first volatility index, India VIX (based on the Nifty 50 Index Option prices) was launched by NSE in April 2008.

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1 Earlier known as Department of Company Affairs.

2 "VIX" is a trademark of Chicago Board Options Exchange, Incorporated ("CBOE") and Standard & Poor's has granted a license to NSE, with permission from CBOE, to use such mark in the name of the India VIX and for purposes relating to the India VIX.

**Direct Market Access:** In April 2008, SEBI allowed the direct market access (DMA) facility to the institutional investors. DMA allows brokers to offer their respective clients, direct access to the Exchange trading system through the broker's infrastructure without manual intervention by the broker.

**Launch of Securities Lending & Borrowing Scheme:** In April 2008, the Securities Lending & Borrowing mechanism was allowed. It allows market participants to take short positions effectively with less cost.

**Launch of Currency Futures:** On August 29, 2008, NSE launched trading in currency future contracts in the USD-INR pair for the first time in India. Trading in other currency pairs like Euro – INR, Pound Sterling – INR and Japanese Yen was further made available for trading in March 2010.

**ASBA:** Application Supported by Blocked Amount (ASBA) is a major primary market reform. It enables investors to apply for IPOs / FPOs and rights issues without making a payment. Instead, the amount is blocked in investors' own account and only an amount proportionate to the shares allotted goes out when allotment is finalized.

**Launch of Interest Rate Futures:** On August 31, 2009, futures on interest rate was launched on the National Stock Exchange.

**Issue of Capital and Disclosure Requirements (ICDR) Regulations 2009:** In August 2009, the SEBI issued Issue of Capital and Disclosure Requirements (ICDR) Regulations 2009, replacing the Disclosure and Investor Protection (DIP) Guidelines 2000. ICDR Regulations 2009 would govern all disclosure norms regarding issue of securities.