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Transformation of Indian Capital Market-Role of National Stock Exchange

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Abstract:
Indian capital market was regarded as one of the most inefficient. As per the risk indices, India's condition was worst in 1990s. Today, India has outperformed many developed countries' capital market and is regarded as one of the best and safest place. The National Stock Exchange played an important role in its transformation. This paper highlights the developments in Indian Capital Market. It explains how NSE acted as a catalyst in the transformation of Indian Capital Market by bringing sophisticated technology in trading and settlements.

Keywords: *Indian capital market, transformation, national stock exchange*

1. Introduction
Capital market is the backbone of any country's economic growth. It is a platform for resource mobilization and allocation. Indian Capital Market is one of the oldest capital markets in the world. The Bombay stock exchange was set up in July 1875 and Ahmedabad stock exchange in 1984. After that many other stock exchanges were established in various parts of the country.
In 1990s, India ranked low in the global ranking of the state of capital markets. In 1992, Bombay stock exchange (BSE) had monopoly. It was an association of brokers. The powerful broker community used to do business as they thought well. Brokers used to look for their own gains and not the interest of the market and the investor community as a whole. The broker community believed that they are the owners of the stock exchanges and they have the exclusive powers to regulate the stock exchange by manipulating prices for their personal gains. Trading was done by 'open outcry' on the trading floor without use of information technology, which was inaccessible to distant users. It was time consuming and an inefficient way of trading (Khan, 2005). Brokers used to charge the investor a price that was different from the actual transacted price. This led to imposition of limits on trading volumes.

2. Literature Review
The literature is full of evidences showing two-way relationship between the developments in the securities market and economic growth.
Levine and Zervos (1998) argue that well developed stock markets may be able to offer financial services of different kind that may provide a different kind of impetus to the economic development.
In India, Agarwall's (1999), study clearly supports the Levine and Zervos's argument and proves that the two main parameters of capital market development namely, size and liquidity, are found statistically significant to explain the economic activity.
Massimb and Phelps (1994) presented a comparative analysis of open outcry system and electronic trading system in US on the basis of two measures of market performance, operational efficiency and liquidity. It was revealed that the decision to move from open outcry to electronic matching forces the exchanges, customers and regulators to face a trade-off between efficiency , liquidity and turnover.
Coles (1999) made an attempt to consider equilibrium a decentralized trade when buyers and sellers met costlessly. The study discussed about the turnover externality which supported multiple-pareto rankable equilibria. The crux was that the greater the flow through of new traders, the easier for everybody to trade. At last, the study revealed when turnover externality existed, all traders better off with higher entry rates of new traders.
Prakash (2001) made a comparative analysis of BSE and NSE, i.e., leading exchanges in the country in terms of number of companies listed, returns, average daily turnover, market capitalization and the number of shares traded during the period 1994-2000 in the study. The author gave a brief account of the functioning of the BSE and NSE. The study concluded that NSE has registered a phenomenonal growth during the period which comprised the entire span of existence.

3. Objective of the study
- To understand the importance of the Indian Capital Market.
- To realize the need for the transformation of Indian Capital Market.
- To learn the role of the National Stock Exchange
- To know the challenges faced in the setting up of National Stock Exchange

4. Research Methodology

Various secondary sources are used to collect information like articles , journals, publications from various websites.

5. Need for Reforms

Banking Scam during 1991-1992 shook the Indian Financial System. Huge money was taken from the banking system by various routes and injected into the capital market by the brokers. Equity prices were also manipulated by the brokers. Thus, there was a need for reform in the capital market.

6. Actions Taken

The government of India delegated powers to SEBI under the securities contracts (Regulations) Act, 1956.Thus, Securities and Exchange Board of India (SEBI) which was set up in 1988, acquired the statutory status in 1992. Since then, SEBI has emerged as an autonomous and independent statutory body to protect the interests of investors and to promote the development of securities market. Since the governance of stock exchanges was very poor, it was realized that empowering SEBI was not enough.

A new model of stock exchange was required to put a competitive pressure on the existing stock exchanges. A professionally managed stock exchange was essential to improve the market. This led to the setting up of National Stock Exchange (NSE). R H Patil was the founder of National stock Exchange who had served as the Managing Director and Chief Executive officer for the first seven formative years. Thus, in order to provide efficiency, liquidity and transparency, NSE was set up as a nationwide, online and fully automated screen based trading system (SBTS) where a member can enter into the computer system the quantities and prices of securities at which they want to transact. Also, the transaction would be executed when it finds a matching sale or buy order from a counter party (Agarwala and Agarwala, 2000). SBTS electronically matches orders on a strict price or time priority and thereby transaction cost and time was reduced (Walia, 2007). NSE became the leading stock exchange in the country, by bringing this change and forcing other stock exchanges to adopt SBTS also.

7. Opposition in Setting up of National Stock Exchange

The broker community was against the idea of setting up of National stock exchange because it was against their interest. They were of the opinion that brokers should be the owners and managers of the stock exchange. Also, the idea of setting up of NSE was to make it nation based. Whereas other stock exchanges were allowed to operate in strictly defined geographical territories based on the city where they were set up. For example, the operation of Bombay stock exchange was confined to Bombay, Delhi stock exchange was confined to Delhi. With the setting up of nation-wide stock exchange, that is, National Stock Exchange, the monopoly power of all the other stock exchanges would come to an end. The smaller stock exchanges would have to compete with the exchange which was supported by the great financial institutions of the country.

8. Fear in Setting up of National Stock Exchange

In order to start computerized trading, it was required that the people should be well educated and technology savvy. But in a country like India, people were illiterate and have no idea about operating a computer system. To overcome this, before starting a formal computerized trading it was decided to provide training to the members.

For this Local Area Network (LAN) was set up in National Stock Exchange's office premises. It was expected that at least three days' training would be required for each dealer. But most of them took only two hours to learn the method and tricks. It was because the software used was of high quality and imported from foreign which was customized by Tata Consultancy Services (TCS). The software was made user friendly.

8.1. The Growth of Internet Trading can be understood from the following Table

Year	**Enabled Members**	**Internet Trading Volume (Rs. in crore)**	**% of Total Trading Volume**
2007-08	305	649,658	9.15
2008-09	349	582,070	10.58

Table1: Growth of Internet Trading from the Fiscal Years 2007-08 and 2008-09
Source: NSE Publication, Fact Book 2009

9. Associated Risks

Badla trading was very popular in Indian market in 1990s as it led to huge speculation. It provided an escape route to the active market market players. Unaccounted money could be easily deployed using Badla. So it was necessary to abolish the Badla system to make Indian Market transparent. During 2000-01, the market observed high speculative activity on the exchanges through badla system. This led to a market crash forcing the government to ban badla. Efforts were made to introduce globally accepted futures and options. The idea to introduce original futures to the country in place of badla was to introduce index futures, index options and stock options. But individual stock futures were issued in a hurry. Individual stock futures are considered to be highly risky as prices can be manipulated by speculators by behaving in a defined manner. Since only margin money is paid in case of futures and not the entire

stock price, so speculation becomes easy. But the case is different for indexed futures. Thus, introduction of individual stock futures posed a huge risk to the Indian Capital Market as it could be used for speculation in the same manner as badla trading was used.
Another risk was the introduction of Promissory notes. When foreign institutional investors invest through Promissory notes in the Indian Capital Market, the sources of funds are not known. Thus, the market can be manipulated.

10. National Stock Exchange (NSE) - A Trend Setter

NSE is the first exchange in the world to use screen based trading system where members have equal access of trade regardless of their location in different parts of the country. This is because they are connected through a satellite network. This system helps to integrate the market and provide a modern system.
The following points explain the role of NSE in nutshell.

- Automated Trading System
- Clearing Corporation- a central counter party which guarantees all settlements
  The National Stock Exchange has a wholly owned subsidiary called the National Securities Clearing Corporation (NSCCL) for settlements.
- Demutualized stock exchange- separation of ownership and management
  NSE is owned by a set of premier financial institutions and/or banks and is managed by professionals who do not trade directly or indirectly on the exchange.
- Nationwide exchange
- No corporate tax exemption
- No entry/exit barriers with regard to membership.
- Fully competitive system
- Settlement on time
- Transparent rules and regulations
- Investors can see prices and quantities of different stocks on a real time basis at terminals
- Depository with dematerialization
  In order to avoid serious issues related to paper based settlement system, a depository was set up where records were maintained in dematerialized form.

11. Limitations in Setting up of NSE

- Innovations were done after years of wait.
- Stock index futures took five years to be offered to the investors since its conception
- Exchange-Traded Fund for Gold again took four years to become a reality

12. Scope for Development

Segmentation of markets within exchanges should be removed. For example Equity spot market and Equity derivatives market are considered different segments. Because of which the financial firms have to obtain separate memberships in each segment. This leads to duplication of compliance costs. And also it becomes difficult to know the full position of the investor.

13. Conclusion

The National Stock Exchange has been continuously growing .The portion of turnover of NSE is the largest as compared to other stock exchanges. Though the number of listed companies on NSE is less than that on BSE, the NSE has outdone all records set by the BSE with regards to average daily turnover. This is because the NSE has a completely mechanized and transparent trading system.
The need is that the Stock exchanges must cooperate to avoid imprudent practices that are harmful for the markets. The market has witnessed fundamental institutional changes, resulting in radical reduction in transaction costs and significant improvements in efficiency, transparency and safety which led the National Stock Exchange to do a remarkable job for the economic development of a country. Not only this, NSE has promoted professionalism in the capital market for providing better securities trading facilities to investors nationwide. We are Indebted to Mr. R H Patil for setting up a nationwide stock exchange. Without whom, the NSE would have been a dream. Setting up of NSE was predicted to fail before it was established because the project was difficult. It transformed a rigid, closed stock market system into a modern, cheaper, safer and transparent system.

14. References

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