

# **Stock Exchanges And Its Recent Developments**

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## **ABSTRACT**

The stock exchange serves as an important institution for the development of capital market of any country. Therefore, working of each stock exchange must assuage very strict international specifications. The advancement of these exchanges is notably difficult in countries in transition, because of reinforcement of economic and legal changes, inadequacy of technical and financial resources, dearth of experience and knowledge in the area of the capital market business, etc. In recent 1990s, the process of economic liberalization was started and brought fundamental changes in the operations of Indian stock market. Rising globalization, economic liberalization, and foreign institutional investments made the Indian stock exchanges vying and influential in their operations. Growth and implementation of the stock exchange represent as responsible and difficult assignments, the realization of which require key financial resources, as well as human and technical resources. Lack of material, staff and technical resources were the major determinants that persuaded many countries that were go through a period of transition to take over the stock exchange information systems of countries with developed market economies. Hence, it is imperative to study the functions and structure of Indian stock exchanges and its recent development.

**Keywords:** Stock exchanges, investors, securities, shares, development.

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## **INTRODUCTION**

In the last few years, Indian Capital Market has go through a tremendous transformation. Each segment of Indian Capital Market whether it is primary markets, secondary markets, derivatives, and institutional investment and market intermediation all has witnessed significant impact of these transition. In recent times, markets are being recognized as one of the most clear, effective and orderly markets. Academicians, policy formulators, practitioners and investors test the degree of competitiveness of the market using numerous techniques and instruments. Stock exchanges are an integral element of the financial markets of all types of economies. They are the big houses of capital

and stronghold of finance. Stock exchanges are the podium of trading in securities and they expedite and control the buying and selling of stocks. Securities and Exchange Board of India has described stock exchanges as, “an association of body of individuals whether incorporated or not, established for the purpose of facilitating, regulating and controlling business in buying, selling and dealing in securities.” Precisely, a stock exchange comprises a platform where shares are traded that is circulated by the public limited companies, central and state governments, public bodies and joint stock companies. Bombay stock exchange was the first organized stock exchange in India and was established in 1875 with the genesis of the ‘Native Share and stock Broker’s Association’. Hence, the Bombay stock exchange is the initial one in the country.

## **REVIEW OF LITERATURE**

Over the past few years, the Indian capital market has changed tremendously. Transformations have also been witnessed in government regulations and technology. The attitude, expectations and perception of the investor’s are also changing. There is only one determinant that is ‘risk’ that has not yet changed and still involved in all types of securities. For both large scale and small-scale investors, managing the risk is emerging as an important determinant. Among academicians and capital market operators, risk management of investing in corporate securities is under comprehensive discussion. For this, various mutual fund companies in India have conducted various studies on the 'risk element' of investing in corporate securities. **Grewal and Grewal (1984)** also disclosed some basic investment rules on selling stocks that also help in managing risk. Researchers made the investors cautious for not buying unlisted stocks, as Stock Exchanges do not permit trading in unlisted stocks. Further, another rule that researchers specify is not to buy inactive stocks that is stocks in which transactions take place infrequently. Key logic why stocks are inactive is due to unavailability of buyers for those stocks (**Yartey, 2008**). Inactive stocks are mainly stocks of those companies that are not doing well. Lastly, researchers also identified not to buy stocks in closely-held companies reason for not buying these stocks is that, these stocks tend to be inactive than those of widely held ones because they have a fewer number of shareholders. Researchers also disclosed that not to hold the shares for a long period of time, expecting a high price, but to sell whenever one earns an acceptable return. Researchers indicated that the significance of the rate of return in investments and reviewed the possibility of bad debts and bankruptcy risks (**Francis, 1986**). Researcher suggested that in an uncertain world, investors couldn’t predict appropriately what rate of

return an investment will gain (**Shleifer et. al., 2006**) further; he disclosed that the investors could formulate a probability distribution of the expected rates of return.

Researchers also suggested that an investor who purchases corporate securities must face the possibility of bad debts and bankruptcy by the issuer. Financial analysts can predict the bankruptcy. Researchers also further indicated some easily notable warnings of a failure of firm, which could be anticipated by the investors to avoid such a risk. **Preethi Singh (1986)** revealed some fundamental principles for selecting the company to invest in stocks. She found that understanding and measuring return and risk is basic to the investment process. As per researcher, most investors are 'risk averse'. To attain maximum return, the investor has to confront greater risks. She also revealed that risk is fundamental to the process of investment. Each investor should have an extensive understanding of the various drawbacks of investments. The investor should carefully analyze the financial statements with special reference to financial competence, Profitability, Earning per share, and capacity of the company. **Scott and Edward (1990)** conducted a study to analyze the integral risks of owning common stocks and the ways to minimize these risks. Researchers revealed and indicated that that the grimness of economic risk depends on how heavily a business depends on debt. Economic risk is comparatively easy to lessen if an investor sticks to the common stocks of companies that occupy small amounts of debt.

The previous research studies have been mainly focused on the origin, speculation and promotion of stock exchanges. However, a review of these studies revealed there has been very little literature on the functioning, structure and recent development of stock exchanges.

## **OBJECTIVES**

- To study the structure of stock exchanges in India.
- To study the functioning of stock exchanges in India.
- To study the recent developments in Indian stock exchanges.

## **RESEARCH METHODOLOGY**

Data has been taken from secondary sources like books, research paper and articles related to stock market and intermediaries. Various books on stock markets have been referred for in depth study.

## **FUNCTIONS OF STOCK EXCHANGES**

The stock market has occupied a key position in the Indian financial system. It includes various economic functions and provides valuable services to the retail investors, corporate, and to the whole financial agents. The various functions of stock exchanges in India are explained as below:

## **(i) Liquidity and marketability of Securities:**

As per the decision of the investor, stock exchanges supply liquidity to companies and investors so that securities can be easily converted into cash at the listed prices (Yasaswy and Tzlrnnrotrrd, 1993). Thus, Stock exchanges assist in buying and selling of securities at the listed prices. Stock exchanges assist buying and selling of securities at listed prices by initiating consistent marketability to the investors with regard to securities they hold or wish to hold. Therefore, they provide a ready podium for dealing in securities.

## **(ii) Supply of long-term funds:**

The attributes of securities that are traded in the stock exchanges are negotiable and exchangeable in nature and they can be transferred from one party to another with minimum formalities. When security is transacted, ownership of securities also changed and long-term availability of funds are assured by corporate.

## **(iii) Profitability:**

The profitability of any company is mirrored through stock prices. Relative profitability and performance of corporate showed by quoted prices. Funds likely to be intrigued towards securities of profitable companies and ensured uninterrupted flow of capital into profitable ventures.

## **(iv) Protection of funds:**

Due to day-to-day operations of investors under stringent rules and regulations, stock exchanges provide protection of funds invested by the investors. Moreover, byelaws are formulated to ensure safety of funds of investors. Through carefully designed set of rules, over-trading, insider trading etc. are obviated. This would promote larger investment and bolster the investor's confidence.

## **(v) Helpful in improved performance:**

The prices listed in stock market mirrored the performance of a company. These prices are more intrigued to investors for investment in stocks. Stock exchanges provide podium for the price quotation for those stocks listed by stock exchanges itself (Rousseau and Wachtel, 2000). A company will be more attentive of its status in the market because of public disclosure and motivates as well to enhance the performance persistently.

## **(vi) Capital formation:**

Stock Exchanges acts as a medium between the savers and investors and therefore, foster investment through capital formation. But in order to achieve this objective of capital formation by the stock

exchanges, surplus funds available with investors both individuals and institutions would have been utilized in productive and remunerative ventures and projects.

## **(vii) Marketing of new issues:**

Companies evaluate their listing by concerned stock exchange authorities and this help companies promptly acceptable by the public for their new issues (Rubio, 2001). Due to this underwriting for issues would be less. Public response to such new issues would be almost high. Therefore, a stock exchange provides assistance in the marketing of new issues also.

## **(viii) Miscellaneous functions:**

With different yields and maturity period, stock exchange provides securities of different kinds. Stock exchanges allow the investors to diversify their risks by different portfolio of investment. Stock exchanges also develop saving habits among the community and provides medium for capital formation. Stock exchanges suggests the investors in choosing stocks by providing the daily pricing of listed securities and by disclosing the trends of dealing on the stock exchange (Jain, 1992). Stock exchanges allow companies and the government to raise funds by providing a podium of ready market for their securities.

## **MANAGEMENT OF STOCK EXCHANGES IN INDIA**

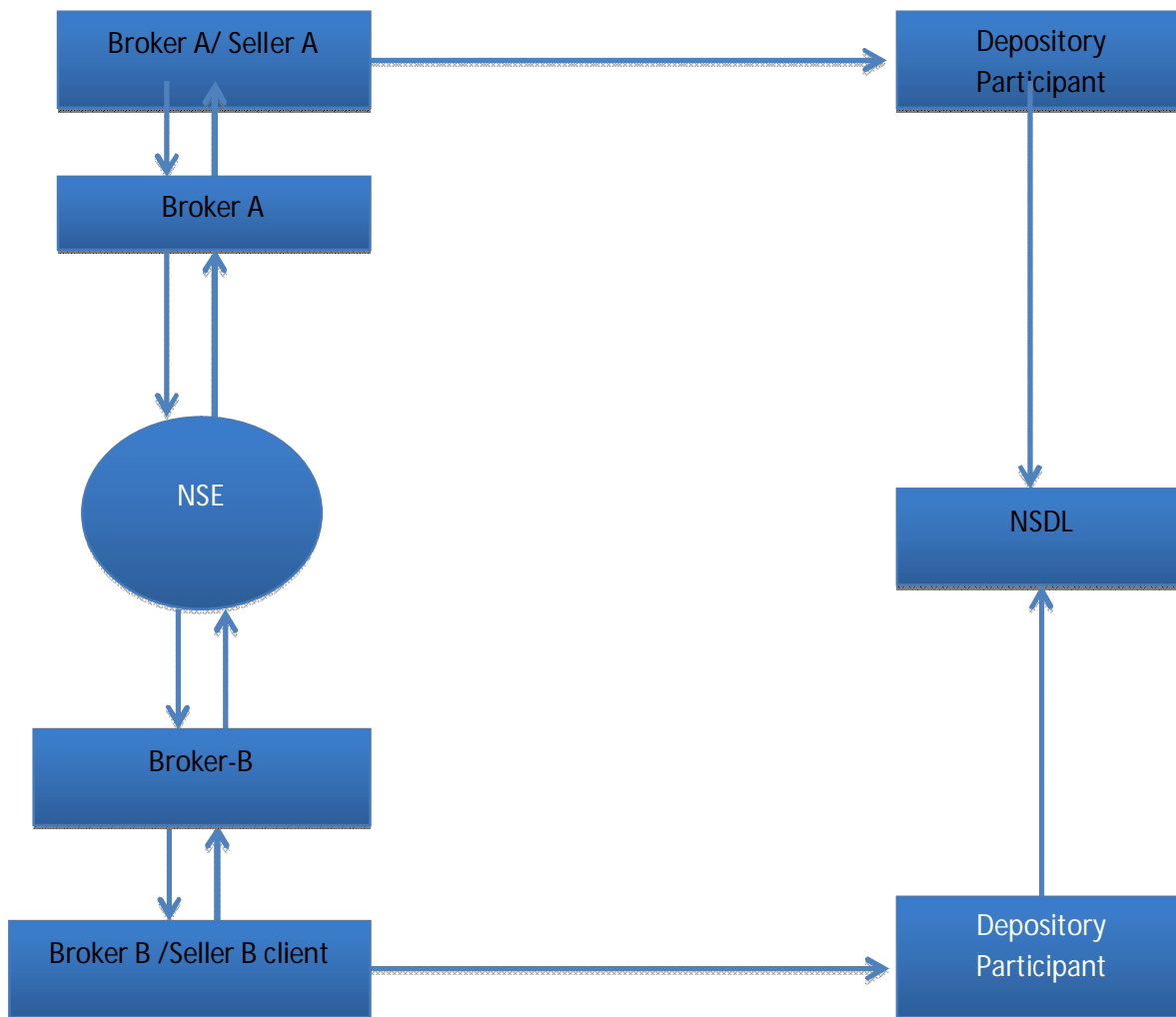
The recognized stock exchanges are managed by, “Governing Board.” Securities and Exchange Board of India has governing board, which comprise of directors, public representatives and government nominees. Governing board also has powers to elect presidents and vice- presidents of stock exchanges and to approve the appointment of the Chief Executive and public representatives (Mandell, 1992). Stock exchanges managed by an apex authority’s chief executive director.

The extensive powers experienced by the governing boards of stock exchanges consist of:

- (a) Appointment of office bearers and setting up of committees like Listing Committee, Arbitration Committee, Defaulter committee, etc.
- (b) Certification and expulsion of members,
- (c) Management of the assets and finances of the exchange,
- (d) Constituting and interpretation of rules, byelaws etc. for the regulation of stock exchanges.
- (e) Settlement of disputes among members or outsiders.
- (f) Management of the day-to-day functioning of the exchange

**WORKING OF STOCK EXCHANGES AND ITS INTERMEDIARIES**

**Figure: 1.1**



**Settlement of Shares**

**Settlement of money**

Source: <http://www.seminaronly.com/Engineering-Projects/Finance/Back-Office-Function-in-a-Stock-Exchange.php>

**Explanation:**

Buyer-B of Broker-B purchases 500 shares of ITC from Broker-A at the same time Seller- A sells 500 shares of ITC to Broker B through Broker-A then following procedure take place B pays to Broker-B the amount due on the shares purchased by him. Broker-B pays the settlement amount to National Stock Exchange that is called funds pay in. National Stock exchange pays the amount to the

seller Broker- A. After that, Seller broker- A pays the amount to seller –A which is known as funds pay out. Simultaneously seller-A delivers 500 ITC to Broker-A in his depository account that is known as shares pay in. After that, Broker-A delivers the shares to National Securities Depository Limited (NSDL) through his Depository Participant (DP). National Securities Depository Limited (NSDL) then gives the shares to broker-B. After that, Broker –B delivers the shares to Buyer-Which is known as shares payout.

An investor who wants to hold his securities in electronic form he has to access a Depository Participant and through him open an account at NSDL. After getting Client Identification number from National Securities Depository Limited, client goes to a registered broker of National Stock Exchange/Bombay Stock Exchange for investing in securities. The client gives the order to the operator seating on the National Exchange for Automated Trading (NEAT software) for particular stock at a determined price when the bid matches on the screen the confirmation tag displays with the scrip International Securities Identification Number (ISIN number) for which he has to take the delivery and make the payment on T+2(Trading day plus two days) basis, if he does not make the payment it goes to auction market and he has to pay the penalty fees and charges and the auction price for the shares traded.

## **MEMBERSHIP OF STOCK EXCHANGES**

A person must have below mentioned qualification, to become a part of recognized stock exchange member:

- A person should be a citizen of India,
- A person should be more than twenty one years of age,
- A person must not be declared bankrupt or insolvent,
- A person must not have been find guilty of any offence including fraud and dishonesty,
- A person should not be involved in any other business besides dealing in securities,
- A person should not be eliminated by any other stock exchanges or stated as a defaulter by any other stock exchange.

## **METHODS OF TRADING IN STOCK EXCHANGES**

The stock exchange activities involved various stages before transaction completes. Those activities or stages are purely vocational in nature and no non-member is allowed to enter without higher

authorities permission. Various stages involved in the trading of stock exchanges are as mentioned as follows:

## **(i) Choice of a Broker:**

Investors who want to sell his shares or potential investors who want to buy shares cannot enter into exchange and do transactions directly. They have to transact through intermediaries. Intermediaries can be brokers or reputed bankers. Therefore, it is an imperative to choose a broker that can be a good reputed banker also. Intermediaries assure precise and quick implementation of transactions from the exchanges. Brokers or bankers assure implementation of transactions at best possible and profitable prices.

Once selection of broker is done, next task is to open an account with broker. In this stage, it has to see whether broker will open an account of investor in brokerage house. Broker will check the financial position of the investor and its related formalities and if found satisfactory, broker will open the account.

## **(ii) Order placement:**

Order placement is the second step that involve buying and selling of securities with the broker. During order placement, order is generally placed through telephone or in person (Gupta, 1992). The facility of telephone is used for communication of buy/sell orders to avoid delays. In order to reduce costs, short abbreviations are used that are “Buy 100 HDFC @ Rupees places orders for buy/sell. 862.” It means, it is an order for the purchase of 100 shares of HDFC Bank @Rupees. 862.

## **(iii) At Best Order**

At best order consists of an order, which does not specify any prefixed price. This type of order must be performed immediately at a best possible price. Investors/trader may also fix specified time frame within which the order has to be executed. E.g. “Buy 100 L&T shares at best.”

## **(iv) Immediate or cancel order**

Immediate or cancel order is an order executed for buying and selling of securities at the price specified by the client. If the order could not be performed at stated prices immediately, it should be treated as cancelled. For example: “Buy 100 DSW @ 65 immediate.”

## **(v) Limit Order**

Limit order is an order for purchase and sale of stocks at a prefixed price that is specified by the client. For example, “Sell 200 ABC Ltd. shares @ Rupees 1286.”

## **(vi) Discretionary Order:**

Discretionary order is an order of buying and selling of shares at a price quoted by the broker himself/herself. This is an order to purchase or sale shares at whatever price the broker thinks reasonable. Such type of orders is only executed when a client has full trust on broker.

## **(vii) Limited discretionary Order:**

Limited discretionary order is an order of buying and selling of securities within a specified mentioned price range and this is also executed at the discretion of the broker as per his/her best judgments and within a given time period.

## **(viii) Open Order:**

Open order is a type of order in which buying and selling of securities is executed without fixing any specified time frame or price limit. Such type of orders is similar to discretionary orders.

## **(ix) Stop Loss Order:**

Stop loss order is an order to save the securities as soon as price falls up to a specific level or purchase the securities when prices of shares rises up to a specific level. Such type of activity is executed mainly to assure the clients against a heavy down or up in prices so that they may not suffer more than the pre-specified amount (Jack,1986). On receiving the orders, they are first recorded in a rough memo book and then they are transferred to the 'Order Book.'

## **(x) Execution of orders:**

The Bombay Stock Exchange has introduced screen – based trading from March, 1995, called BOLT (BSE on Line Trading). This type of trading helps the clients to get the best offers and bids from the order book. If the price does match with buyer and seller price, the order will remain in the system for the whole day, until it gets executed.

## **(xi) Formation of Contract Notes:**

Generally, the brokerage houses enter the particulars of the business that is transacted during a particular day through e-contract. These electronic contracts commonly known as e-contract, emailed on the same day after market hour and physical delivery of contracts at client's address sends within two days from his/her order execution.

## **(xii) Settlement of transactions:**

In stock exchanges, settlements are done on rolling basis that is no account period settlement. Every order will be given unique settlement date that will be mentioned upfront at the time of order entry and this process used as a matching parameter (Sarr and Lybek, 2002). It is important for trades to be

settled on the predetermined settlement date. At present, settlement period ranges from T+1 to T+2. T+2 is done for equity shares and T+1 for derivatives product.

### **(xiii) Clearing settlement:**

In this stage, transactions for clearing settlement are routed through clearing corporations. In routine, traded securities are regulated and cleared through clearing house. These routine transactions are known as the transactions for 'the account.' Prior approval from the exchange needs to be obtained in case of delay of settlement and also cancellation of trade. The exchange rooted arbitration mechanism for solving disputes arising from trades or settlements.

## **RECENT DEVELOPMENTS**

Some of the recent changes in the developments of stock exchanges in India are as following:

### **(i) Management of intermediaries:**

Securities exchange board of India has exercised stringent control on stock exchanges to enhance the functioning of intermediaries in the capital market. The intermediaries registered with Securities Exchange Board of India are merchant bankers; brokers, sub-brokers, underwriters, bankers to the issue etc. It is suggested that the registration required renewal from time to time in spite of making it a constant one (Grewal, 1984). SEBI has authority to suspend stock exchanges after conducting an enquiry. In order to enhance stock exchange's financial adequacy, capital adequacy criteria have been fixed.

### **(ii) Demand of Quality Securities:**

For efficient and efficient working of a stock exchange, quality securities are absolutely vital. Attaining this fact, the SEBI has announced recently amended criteria for companies accessing the capital exchanges (Scott. and William,1990). Participation of financial institutions in the capital is vital for entry into the capital market. These measures ensure that only quality securities into the market.

### **(iii) Use of blocked amount (ASBA) facility in public issues and right issues:**

Securities and exchange board of India has launched the ASBA (Application Supported by Blocked Amount) facility as on July 30<sup>th</sup> 2008 to make the existing public facility more efficient This type of ASBA facility is made available to individual investors also. Application supported by blocked amount (ASBA) is an application that is used as a sanction to crossbar the application money in the bank account. This application is used for subscribing to an issue (Galindo and Mico, 2004). If an investor is doing trading through Application supported by blocked amount(ASBA), then his

application money will be taken from bank account only. This will be executed only if investor application is selected for allotment.

#### **(iv) Change in the management composition:**

In the early years, the boards of stock exchanges were domineering by brokers whose decisions were not fair and transparent. But now SEBI requires that 50 percent of the directors must be non-brokers directors or government representatives (Bamodar, 1993). Moreover, it is essential that non-broker professional shall be appointed as the executive Director.

#### **(v) Injunction of insider trading:**

Earlier, insiders because of their position in the company easily enter into manipulative dealings. These dealings are contrary to the interest of the public and available to the public on the basis of unpublished price conscious information (Randall, 1992). On the basis of any unpublished price sensitive information, an insider is prohibited from dealing on securities of any listed companies. Therefore, there is a prohibition on insider trading. Now, Securities Exchange Board of India has been established new regulation that is SEBI (Insider Trading) Amendment Regulations, 2002. This regulation has given more powers to SEBI to control insider trading. The definition of insider trading have been established SEBI more firmly and enforceable in a court of law.

#### **(vi) Quarterly informing by Foreign Venture Capital Investors:**

All Foreign Venture Capital Investors operating in India have to submit quarterly reports to SEBI, with effect from 31<sup>st</sup> March 2010. Within seven days from the end of each calendar quarter, the reports need to be displayed in the SEBI portal. These measures can be seen as making the working of FVCI more transparent and in order. One of the prompt reason for the fastest recovery of markets in 2008-09 was timely regulations and policies introduced by SEBI.

#### **(vii) Prohibition of price rigging:**

More powers have been given to SEBI that comes under SEBI (Prohibition of fraudulent and unfair trade practices relating to security markets) regulations, 1995 to control price rigging. In reality, the SEBI exercised its authority in 1996 for the first time by declare show- cause notices to the various parties- brokers, clients, promoters, and involved in price rigging. In addition, certain procedural changes have been planned in the auction route to control price rigging. Therefore, all efforts are being taken to protect the interest of genuine investors (Ayling, 1986).

**CONCLUSION**

In any country's economy, economic development is reflected by the development of the Stock exchanges. Stock exchanges consists of a place where shares, debentures, bonds and derivative products are bought and sold either in the form of investment or in the form of speculation. Stock exchanges are a market where transactions related to secondary markets are bought and sold. In order to ensure smooth functioning of stock exchanges, Securities Exchange Board of India comes up with various regulations time-to-time. During financial crisis, expeditious recovery of the market was possible because of orderly and controlled regulations of SEBI.

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