Research Paper Management

Stock Markets in India: Need for More Robust Mechanisms to Check Misgivings

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ABSTRACT

This paper while discussing the characteristics of the Indian stock market also discusses the problems associated with the same with a historical perspective. It goes on to prove that efforts have been placed by regulators to control the misgivings like insider trading and other trading violations, there has been cases of these galore in the history. Some of the incidents are discussed in detail.

KEYWORDS

Introduction

Indian stock markets have seen tremendous change in the secondary market operations especially in the equity market. Post reforms in 1991, a series of market reforms was introduced to improve investor protection and to increase the efficiency of the market operations. SEBI was established in 1992, as the market regulator. As a sole authority SEBI has the task in hand to regulate all market participants and simultaneously develop capital market in the country. The premier stock exchanges of the country namely BSE and NSE were automated, NSDL and CDSL were established to hold securities in de-mat form, and individual brokers were encouraged to get themselves corporatized. Along with this, series of measures were taken for disclosure in company accounts and balance sheets and other material information to be provided from time to time, to all stake holders and especially to stock holders that may have a bearing in their investment. Easy trading and better settlement procedures have been adopted. In the process Indian stock market have come a long way and now technologically considered having achieved global standards. The fruits of reforms in the stock market have seen in the form of increase in participation of not only Domestic Institutional Investors (DII), Individual Investors and also Foreign Institutional Investors (FII). In stock market both Equity (Spot and Futures& Options) and Debt are traded, but stock market in India is synonym with equity. As such for the purpose of this paper, we will limit our study to equity. Also whether, these developments in the stock markets in India can be attributed to a perfect competition market. For this we need to understand the characteristics of perfect competition as well as the Indian Stock Market.

Characteristic of perfect competition

As per classical economics, the main characteristic of a perfect competitive market is that there are large numbers of buyers or sellers of the same product. No single market participant (buyer or seller) can influence the prices in the market. Individual buyers and sellers are price takers. Customers and firms take market prices as given and devise their buying and selling strategies according to prevailing market situations. Free and complete demand and supply information is available and there are generally no entry or exit barriers. As such, vigorous price completion prevails in the market place and only a normal rate of return is possible in the long run. Economic profits are possible only during short-run disequilibrium before rivals come in with an effective competitive response.

Therefore the main characteristics of perfect competition are:

1. Large number of buyers and sellers: Each firm produces a small portion of industry output and each customer buys a small portion of the total output.

2. Product homogeneity: The output of each firm is the same of that of other firm in the industry.

3. Free Entry and Exit: Firms are not restricted from entering or leaving the industry

4. Perfect Dissemination of information: Cost, price and product quality information is available and known by all buyers and sellers.

5. Opportunity for normal profits in the long-run equilibrium: The price competition in the market keeps P=MC and P=AR=AC.

Characteristics of Indian Stock Market

Even though, Indian stock market have technologically developed and SEBI has taken hosts of measures for investor protection in the form of disclosures by companies and providing strict regulations for all other stock market participants, often we come across with news of insider trading and market manipulation. Therefore, in stock market parlances, we need to analyze the following key elements those have a bearing on stock price to understand the timely availability of price sensitive information to general investors.

These are mainly;

1. The timely availability of information about a stock that may have a bearing on the stock price. In other language, it is called insider trading if the price sensitive information is available to an individual or only to a select group, and have derived benefit out of it directly or indirectly.
2. Similarly, the other important aspects to be considered are, not a single or groups of buyer/seller have influenced the price/ quantity volatility, both from buyer as well as seller side need to be analyzed (Market manipulation).

Insider Trading Incidence in Indian Stock Market

In November'2008, the stock market regulator, SEBI introduced insider trading rules relating to definition of insider, trading restrictions and timeliness of reporting of insider trades. Through this regulation the regulator has tried to control short term profiteering and also increase reporting standards of people associated with the firm.

The insider trading data of 9383 for the period 2007 to 2009 reported were studied and found that prior to the regulatory intervention inside traders observed were rampant and the insider had made Rs.4/- more profit that the ordinary investor during the same trading period. The study also shows that there has been a significant reduction in insider trading cases post regulatory intervention.@

1. SEBI Adjudication order dated 27th July'2012 2012 in respect of Mr. G Jayaraman in the matter of Satyam Computer Services Ltd.

Vide the aforesaid Order, SEBI has held that Mr G Jayaraman, erstwhile compliance officer of Satyam Computer Services Ltd, liable for not enforcing the safeguards under the Model Code during the period of December 2008 – January 2009. Mr. G Jayaraman was also the Company Secretary of Satyam.

The particular safeguard which they said Compliance Officer had failed to enforce was to close the trading window after becoming aware of certain "price sensitive information" relating to Satyam i.e; potential merger of Maytas with Satyam, which was yet to be confirmed by the Board of Satyam. SEBI imposed a fine of Rs.5 lacs on him.

2. SEBI identified front running involving an employee at a leading mutual fund company and passed an interim order in June 2010, with a total penalty amount of Rs. 55 lakh.

3. SEBI observed that three individuals were trading ahead of the trades of Citigroup Global, based on trading based information leaked by a Hong Kong-based Citigroup trader. Total penalty of Rs 1.19 crores was imposed on them.

4. Adjudication order dated November 29, 2012 was passed against M/s DFM Foods Ltd and a penalty of Rs.1.50 lacs was imposed on Mr Mohit Satyanand, for violation of insider trading norms of listed companies.

Price Manipulation Incidence in Indian Stock Market

1. On July 26, 2012, SEBI surveillance, observed abnormal downward movement of certain company scripts; namely M/s Pipavav Defence & Offshore Eng. Ltd, M/s Parsvanath Developers Ltd, M/s Tulip Telecom Ltd and M/s Glodyne Tchnoserve Ltd as compared to the previous closing trading prices at NSE and BSE. After investigation SEBI barred eight entities from the market.
2. SEBI carried out an investigation of artificially increase in "marking the close" in cash segment M/s Ruchi Soya Industries Ltd , which act as the settlement price in derivatives market. There were certain connected entities involved in artificial price manipulation and thus realized higher settlement price from their futures transaction and found guilty.
3. Adjudication order dated April 30, 2012 and June 20, 2012 was passed in the matter of M/s S J Construction Ltd wherein a penalty of Rs.50,000/- each was imposed on M/s India Advantage Securities Ltd and M/s Inventure Growth and Securities Ltd for violation of SEBI (Stock Broker and Sub-Broker Rule), 1992.

There are about 155 various kindly of cases involving company employees, directors, brokers, lead managers, book runners and other entities have been taken up for investigation by SEBI during the year and about 119 cases have been completed at the same period. In many cases after verification, SEBI has also pass interim or adjudication orders. About 44 percent of the cases where investigation completed pertain to manipulation and 34 percent pertain manipulation and price rigging. (Source: SEBI Annual Report'2013).

The above cases imply that still there are cases of issue manipulation, manipulation and rigging of price exists in the market which has a negative impact on the market and to the ordinary investors. Still there are instances of top managements of companies involved in unfair trading observed and getting punished. There are also instances observed where other market participants like brokers, sub-brokers, lead managers, book runners involving themselves in unfair trading practices to gain more than normal profit from the market, which is clearly not in conformity with the perfectly competitive market. In all such cases generally the small investor are at the receiving end. Because of which, participation of small investors in Indian Stock market is very limited and in fact after the subprime crisis of 2008 small investor participation in the market has gone down. As such Indian Stock Market is not a perfect completion market.

Conclusion

There is an extraordinary growth in the investment sector both in terms of volume and number of investors in India over the past decade due to the deregulation of Indian financial sector. There is a spurt of various investment products with numerous options to lure the investors to invest. The commodity market is getting momentum, the reality market is booming, the Gold market is at its peak, the capital market reforms also boosted the investors to invest huge fund in share market, the advancement in technology also heighten the investment opportunities to the small and medium investors at present. Thus it becomes essential that the regulators and the various other stakeholders of stock exchanges be proactive in taking care of the interests of the individual investors.

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