Bombay and National Stock Exchange in India – An overview

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Abstract

This paper author looks at the challenges and the coming opportunities in the Indian stock market to streamline the equity and bond markets. It is a place where shares of pubic listed companies are traded. The primary market is where companies float shares to the general public in an initial public offering (IPO) to raise capital.Once new securities have been sold in the primary market, they are traded in the secondary market—where one investor buys shares from another investor at the prevailing market price or at whatever price both the buyer and seller agree upon. The secondary market or the stock exchanges are regulated by the regulatory authority. In India, the secondary and primary markets are governed by the Security and Exchange Board of India (SEBI).A stock exchange facilitates stock brokers to trade company stocks and other securities. A stock may be bought or sold only if it is listed on an exchange. Thus, it is the meeting place of the stock buyers and sellers. India's premier stock exchanges are the Bombay Stock Exchange and the National Stock Exchange. Foreign institutional investors play a very important role in any economy. These are the big companies such as investment banks, mutual funds etc, who invest considerable amount of money in the Indian markets. With the buying of securities by these big players, markets trend to move upward and vice-versa. They exert strong influence on the total inflows coming into the economy.

Market regulator SEBI has over 1450 foreign institutional investors registered with it. The FIIs are considered as both a trigger and a catalyst for the market performance by encouraging investment from all classes of investors which further leads to growth in financial market trends under a self-organized system. A company offering its shares to the public is not obliged to repay the capital to public investors.

The company which offers its shares, known as an 'issuer', does so with the help of investment banks. After IPO, the company's shares are traded in an open market. Those shares can be further sold by investors through secondary market trading.

Keywords— SEBI, Mutual Funds, Hedge Funds, Banks, Insurance Companies, BSE, NSE, Capital Market Segment, Capital Inflows.

Introduction

Mark Twain once divided the world into two kinds of people: those who have seen the famous Indian monument, the Taj Mahal, and those who haven't. The same could be said about investors.

There are two kinds of investors: those who know about the investment opportunities in India and those who don't. India may look like a small dot to someone in the U.S., but upon closer inspection, you will find the same things you would expect from any promising market.Here we'll provide an overview of the Indian stock market and how interested investors can gain exposure.

The BSE and NSE

Most of the trading in the Indian stock market takes place on its two stock exchanges: the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). The BSE has been in existence since 1875. The NSE, on the other hand, was founded in 1992 and started trading in 1994. However, both exchanges follow the same trading mechanism, trading hours, and settlement process.

As of February 2017, the BSE had 5,518 listed firms,1 whereas the rival NSE had about 1,799 as of Dec. 31, 2017.2 Out of all the listed firms on the BSE, only about 500 firms constitute more than 90% of its market capitalization; the rest of the crowd consists of highly illiquid shares.

Almost all the significant firms of India are listed on both the exchanges. The BSE is the older stock market but the NSE is the largest stock market, in terms of volume. As such, the NSE is a more liquid market. In terms of market cap, they're both comparable at about $2.3 trillion. Both exchanges compete for the order flow that leads to reduced costs, market efficiency, and innovation. The presence of arbitrageurs keeps the prices on the two stock exchanges within a very tight range.

Trading Mechanism

Trading at both the exchanges takes place through an open electronic limit order book in which order matching is done by the trading computer.3 There are no market makers and the entire process is order-driven, which means that market orders placed by investors are automatically matched with the best limit orders. As a result, buyers and sellers remain anonymous.

The advantage of an order-driven market is that it brings more transparency by displaying all buy and sell orders in the trading system. However, in the absence of market makers, there is no guarantee that orders will be executed.

All orders in the trading system need to be placed through brokers, many of which provide an online trading facility to retail customers. Institutional investors can also take advantage of the direct market access (DMA) option in which they use trading terminals provided by brokers for placing orders directly into the stock market trading system.

Settlement and Trading Hours

Equity spot markets follow a T+2 rolling settlement.4 5 This means that any trade taking place on Monday gets settled by Wednesday. All trading on stock exchanges takes place between 9:55 a.m. and 3:30 p.m., Indian Standard Time (+ 5.5 hours GMT), Monday through Friday. Delivery of shares must be made in dematerialized form, and each exchange has its own clearing house, which assumes all settlement risk by serving as a central counterparty.

Objective:

Author explore the challenges of the Indian stock market and how those challenges can be turned into opportunities to strengthen the Indian economy through various instruments equities derivatives bonds and others

Market Indexes: Challenges

The two prominent Indian market indexes are Sensex and Nifty. Sensex is the oldest market index for equities; it includes shares of 30 firms listed on the BSE, which represent about 47% of the index's free-float market capitalization.6 It was created in 1986 and provides time series data from April 1979, onward.

Another index is the Standard and Poor's CNX Nifty; it includes 50 shares listed on the NSE, which represent about 46.9% of its free-float market capitalization.6 It was created in 1996 and provides time series data from July 1990, onward.

Market Regulation

The overall responsibility of development, regulation, and supervision of the stock market rests with the Securities and Exchange Board of India (SEBI), which was formed in 1992 as an independent authority. Since then, SEBI has consistently tried to lay down market rules in line with the best market practices. It enjoys vast powers of imposing penalties on market participants, in case of a breach.

Who Can Invest in India? Investing Opportunity

India started permitting outside investments only in the 1990s. Foreign investments are classified into two categories: foreign direct investment (FDI) and foreign portfolio investment (FPI). All investments in which an investor takes part in the day-to-day management and operations of the company are treated as FDI, whereas investments in shares without any control over management and operations are treated as FPI.

For making portfolio investments in India, one should be registered either as a foreign institutional investor (FII) or as one of the sub-accounts of one of the registered FIIs. Both registrations are granted by the market regulator, SEBI.

Foreign institutional investors mainly consist of mutual funds, pension funds, endowments, sovereign wealth funds, insurance companies, banks, and asset management companies. At present, India does not allow foreign individuals to invest directly in its stock market. However, high-net-worth individuals (those with a net worth of at least $50 million) can be registered as sub-accounts of an FII.

Foreign institutional investors and their sub-accounts can invest directly into any of the stocks listed on any of the stock exchanges. Most portfolio investments consist of investment in securities in the primary and secondary markets, including shares, debentures, and warrants of companies listed or to be listed on a recognized stock exchange in India. FIIs can also invest in unlisted securities outside stock exchanges, subject to the approval of the price by the Reserve Bank of India. Finally, they can invest in units of mutual funds and derivatives traded on any stock exchange.

An FII registered as a debt-only FII can invest 100% of its investment into debt instruments. Other FIIs must invest a minimum of 70% of their investments in equity. The balance of 30% can be invested in debt. FIIs must use special non-resident rupee bank accounts in order to move money in and out of India. The balances held in such an account can be fully repatriated.

Restrictions and Investment Ceilings

The government of India prescribes the FDI limit, and different ceilings have been prescribed for different sectors. Over a period of time, the government has been progressively increasing the ceilings. FDI ceilings mostly fall in the range of 26% to 100%.

By default, the maximum limit for portfolio investment in a particular listed firm is decided by the FDI limit prescribed for the sector to which the firm belongs. However, there are two additional restrictions on portfolio investment. First, the aggregate limit of investment by all FIIs, inclusive of their sub-accounts in any particular firm, has been fixed at 24% of the paid-up capital. However, the same can be raised up to the sector cap, with the approval of the company's boards and shareholders.Secondly, investment by any single FII in any particular firm should not exceed 10% of the paid-up capital of the company. Regulations permit a separate 10% ceiling on investment for each of the sub-accounts of an FII, in any particular firm. However, in the case of foreign corporations or individuals investing as a sub-account, the same ceiling is only 5%. Regulations also impose limits for investment in equity-based derivatives trading on stock exchanges.

Investments for Foreign Entities challenges

Foreign entities and individuals can gain exposure to Indian stocks through institutional investors. Many India-focused mutual funds are becoming popular among retail investors. Investments could also be made through some of the offshore instruments, like participatory notes (PNs), depositary receipts, such as American depositary receipts (ADRs) and global depositary receipts (GDRs), exchange-traded funds (ETFs), and exchange-traded notes (ETNs).

As per Indian regulations, participatory notes representing underlying Indian stocks can be issued offshore by FIIs, only to regulated entities. However, even small investors can invest in American depositary receipts representing the underlying stocks of some of the well-known Indian firms, listed on the New York Stock Exchange and Nasdaq. ADRs are denominated in dollars and subject to the regulations of the U.S. Securities and Exchange Commission (SEC). Likewise, global depositary receipts are listed on European stock exchanges. However, many promising Indian firms are not yet using ADRs or GDRs to access offshore investors.

Retail investors also have the option of investing in ETFs and ETNs, based on Indian stocks. India focused ETFs mostly make investments in indexes made up of Indian stocks. Most of the stocks included in the index are the ones already listed on the NYSE and Nasdaq.

As of 2017, two of the most prominent ETFs based on Indian stocks are iShares MSCI India ETF (INDA) and the Wisdom-Tree India Earnings Fund (EPI). The most prominent ETN is the iPath MSCI India Index Exchange Traded Note (INPTF). Both ETFs and ETNs provide a good investment opportunity for outside investors.

The Bottom Line

Emerging markets like India are fast becoming engines for future growth. Currently, only a very low percentage of the household savings of Indians are invested in the domestic stock market, but with gross domestic product (GDP) growing at 7% to 8% annually for the last few years, though in the 6% range for 2017 and 2017, and a stable financial market, we might see more money joining the race. Maybe it's the right time for outside investors to seriously think about joining the India bandwagon.

Gems and Jewelry also picked up in May and stood at USD 1.1 billion from negligible exports in April but still shows a contraction of 69% on Y-o-Y basis. One category that has been consistently exhibiting silver lining is ‘Organic, Inorganic and Agro Chemicals.’. The category clocked exports of USD 1.8 billion in May, a 50% growth Y-o-Y . Overall, covid-19 is looking like another shock to labour intensive exports of Gems and Jewelry, textiles while being positive for essentials such as Chemicals and Pharmaceuticals. Imports- Reflection of subdued domestic demand Imports rose by USD 5.1 from April, with total being USD 22.2 billion. Petroleum imports fell further to USD 3.5 billion, reflecting a fall in prices and demand. Though non-oil imports showed an uptick from the bottom, they contracted by 43% Y-o-Y, reflecting the sluggish domestic demand. A fall in non-oil imports will also adversely affect GoI tax collections. The fall in non-oil imports is consistent with other domestic demand indicators such as automobiles sales, industrial production etc. Gold and silver imports were down 92% Y-o-Y. Outlook- Comfortable external position ahead We reiterate our hypothesis that global demand will revive much faster owing to falling dollar, unprecedented fiscal and monetary stimulus, a faster reopening, and a general improvement in sentiment. On the other hand, India’s demand recovery could be much slower, in the absence of a stimulus. This will lead to a faster revival in exports than imports, reducing India’s merchandise trade deficit to ~4%

of GDP in FY21 from 5.2 % of GDP in FY20. Services might suffer on trade and transportation, but software services will continue to be resilient. Overall, we believe FY21 Current Account Deficit could be between 0.1-0.3% of GDP. Valuations continue to remain attractive especially outside the Nifty50 set of companies.

Mid and Small cap companies, which are the market leaders in industry subgroups, represent an attractive set of investment ideas. Moreover, India's monetary policy continues to remain easy and we expect the RBI to put to use both conventional and unconventional policy tools to support growth. A fresh set of fiscal measures later in the year could potentially address the recovery and demand dynamics. We investors should continue to allocate to equity, about 5% of their investible surplus a week, in a staggered manner. The allocation of fresh investible surplus should be raised to nearly two third of available funds. It continues to be a buy on dips rather sell at high market.

We expect GOI 10 Yr bonds yields, AAA and AA Corporate bond yields to slide from their current levels. With near zero wholesale level inflation and likely flattish nominal growth Indian bond markets offer attractive return prospects across instruments. We expect the term and risk premium across issuers, especially for investment grade bonds, to decline further. The US Federal Reserve is adding record amount of assets to its balance sheet. With a cooling off of risk aversion, improvement in global trade and therefore in the BOP of commodity exporters, a US Dollar fall of significant scale is already underway. This will address tight monetary conditions in most Emerging Markets, and help them stage a recovery. The US Fed's attempt to not only create reserves at the bank balance sheets but to push and cause banks to lend is causing credit growth to pick up and will likely aid euro dollar accretion.

Conclusion

A stock exchange is precisely a platform that conducts the trading of financial instruments like stocks and derivatives. The activities on this platform are regulated by the Securities and Exchange Board of India.The participants have to register with SEBI and the stock exchange in order to conduct trades. Trading activities include brokering, issuing of shares by companies, etc. b. Listing of the Company in the Primary Market A new company is listed in the primary market through the process of an Initial Public Offering, where the company lists details about itself, the stocks it is issuing, etc.

The allotment of stocks take place during the process of listing and investors who bid for the stocks get their share. Trading in the Secondary Market Once the company has been listed and issued stocks, these can be traded in the secondary market by the investors. This is the marketplace for the buyers and sellers to transact and make profits or incur losses.

Stock Brokers Because of the magnitude of investors who number in thousands, it is difficult to have them assemble in one location. Therefore, to conduct trade, stock brokers and brokerage firms come in the picture. These are entities that are registered with the Stock Exchange and act as intermediaries between the investors and the exchange it self. When you place an order to buy any share at a given rate, the broker processes it at the exchange where there are multiple parties involved. e. Passing of your order Your buy order is passed on to the exchange by the broker, where it is matched for a sell order for the same. The exchange takes place when the seller and the buyer agree upon a price and finalize it; the order is then considered confirmed. Settlement Once you finalize on a price, the exchange confirms the details to ensure that there is no default in the transaction. The exchange then facilitates the transfer of ownership of the shares which is known as Settlement. You receive a message once this takes place. This communication of this message involves multiple parties like the brokerage order department, the exchange floor traders, etc

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