Laws Regulating Stock Market in India

Dr. Varsha Agarwal,
Assistant Professor & Research Coordinator, Department of Management,
Center for Management Studies, JAIN (Deemed-to-be University), Bangalore, India
Email Id: varsha_a@cms.ac.in

ABSTRACT: In the entire financial system of the country, stock markets have been regarded as the budding and vibrant stem stepping out of it. It won't be wrong to state that Stock Markets do contribute through a significant approach to economy of the country. It is defined as an area where the buyers and the sellers face no restrictions while buying and selling the shares, debentures, etc. from each other. With emergence of liberalization and globalization, stock market of India has recorded a material advancement in field of trading, be it mobilizing shares or capitalizing them. In addition, persons dealing within security markets like investors, intermediaries and issuers of shares have also been given recognition. There has been a major institutional shift in the sector, resulting in a dramatic reduction in transaction costs and a substantial increase in performance, transparency and protection. This paper aims to analyze the concept of stock market in depth along with laws regulating this market in India. The author will through a light on the historical evolution of stock market its types and the laws related to the same.

KEYWORDS: Stock Market, Financial System, Share, Debenture, SEBI, Money Laundering.

INTRODUCTION

Stock market contributes to economy of the country in a pronounced manner. It is an implied and non-detachable element of any company as it furnishes economic growth of the company and raises capital for it. The market facilitates investors to pool huge amount of capital for long term ultimately giving rise to expansion of economy. It also aids in expansion of clients for companies in need by offering huge amount of shares and other equities. The healthy economy reflects the health of stock market and graph of its performance has reflected the fact that stock market has secured its place as an imperial and important contributor of the economy. However, beyond any reasonable doubt it is witnessed that relationship shared by economic growth and development in stock market along with stock prices are not independent and are based upon additional factors. These additional factors include inflation –deflation, demand and supply factors, exchange rates etc. The indications have been traced stating that stock prices are influenced through financial factors.

There was a time when people used to sit and invest under the tress. There was no proper structure and infrastructure in the country to properly conduct trade. With passing of clouds, rapid increase was recorded in numbers of brokers. They were shifted to location named Dalal Street in 1854 and currently that place is renowned as Bombay Stock Exchange. In Asia, it is the oldest stock exchange. Being the first stock exchange it has made important contribution to era of stock exchange in country.

The Stock Exchange of India has acquired a prestige position at global level. India has two national stock exchange markets. First is Bombay Stock Exchange which is also denoted as BSE. It is counted as the oldest among other existing Exchanges within world. Another is National Stock Exchange of India Limited. It has retained the stop of leading stock exchange with regards to advanced technological equipment and efficiency. Since early 90's stock markets of India gained fluency, have made their grip and are holding it till date. Experiments were conducted during the mentioned period to mold stock markets operation effectively and efficiently.

Stock Markets have two branches which are primary market and secondary market. These markets deals with securities like bonds, derivatives, pooled money, mutual funds, and shares as issued by companies, etc. and are regulated under distinct laws which are deeply discussed in latter portions of this paper.

DISCUSSION

1. *Stock Meaning*

Stock can be elaborated and understood as a financial instrument which acts as an eminent evidence exhibiting ownership in company and asserts the right over the segment of assets of the company. This entitles the owner of the stock to a proportion of the corporation's assets and profits equal to how much stock they own.[1] Shares are the component of stock.

2. *Common Stock*

It is a variety of stock that asserts the ownership in a company. People usually prefer to invest in common stock. If the company generates profit, investors having common shares have right to claim that profit in forms of dividends. Such stock also provides investors to cast one vote per share to choose board members. Therefore, such stockholders have control over decisions of companies.

In case of liquidation of the company, common shareholders will only be paid after paying the full amount to other shareholders like preferred shareholders, debenture holders, bond holders, etc.

3. *Preferred Stock*

Shareholders of preferred stock have priorities over shareholders of common stocks. But on the other hand, preferred shareholders do not have voting rights. In short, they make no significant contribution for moulding the company's future. In the instance of liquidation of company, such shareholders are given preference. They are entitled to claim assets of company prior to common stock's shareholders.

4. *Stock Market Meaning*

A stock market is just like any other market but here instead of ordinary items financial securities are sold. When companies issue the securities, they are brought and are purchased by the investors who are willing to invest in the respective companies. Stock Market is an essential component of capital market ecosystem.

It is a requisite that interested companies to list their securities on stock exchange have to sign the agreement with stock exchange stating the permission to trade such securities at particular stock market. Ones the company is listed, it becomes eligible to issue securities to the public in primary market.

These securities include shares, debentures, bonds, etc. Liquidating the securities is the essential task of Stock exchanges. A mechanism is set out within stock exchange that enables the best buyer to buy form the best seller or best buying order matches the best-selling orders. An amount is levied upon trading members by Stock exchanges and that amount becomes the earning of Stock exchanges. Two renowned Stock Exchanges in India are BSE, formerly known as Bombay Stock Exchange, and National Stock Exchange-NSE.

5. *Historical Evolution of Indian Stock Market*

As mentioned previously, in the early attempts when industrialization held at India in the late nineteenth and early twentieth centuries, the Indian stock markets played an important part. The stock market was financed by the early textile mills and the first steel plants in beginning. In comparison to the scale of the financial sector in those days, those capital raising activities were massive.

The country launched and instituted upon a prejudiced reforming model of growth starting in the late fifties that strived to place the emphatic heights of economy under the province governed by public solely.

The instance when banks and insurance companies were brought under governmental control or nationalized, State automatically took charge of the distribution of capital in the economy and the growth of financial institutions witnessed its immense growth and importance. A policy of financial repression started taking its existence, deteriorating the stock market.

[1] https://www.investopedia.com/terms/s/stock.asp

The journey of stock market in between 1984 to 1992 was considerably effective and achievable for Indian capital markets in several respects. The stock market shot through the roof as the markets reacted enthusiastically to the first wave of changes in the mid of 1980 and the big reform initiative of 1991. Unexpectedly, stock market index recorded the growth more than ten times from October 1984 to September 1992, showing 34% annual compound return.

Immense progress was witnessed in 1990s, especially when on February 2006; Sensex crossed the mark of 10,000 and in March against it touched the heights of 11,000 mark. It was surprising to record such a growth breaking records one after another within very less time.

6. Type of Stock Market in India

6.1.Primary Share Market

This market imposes liabilities and obligations while furnishing opportunities to raise funds for attaining the investment requirement for the one issuing shares, in general companies. Companies are obligated to get themselves registered for raising money through shares[2].

The process has been rewarded with the name of listing on the stock exchange. The objective of a company to raise funds is consummated when it offers its shares to public for the 1st time by way of Initial Public offering also known as IPO in primary market.

This window of IPO is open for limited period in which interested investor can purchase the shares at the same price offered by companies. As soon as the window is shut shares are allotted to investors or general public by virtue of which the companies turn out to be a public entity.

To accomplish such process, it is necessity of company to pay a fixed amount to stock exchange along with purveying essential information like income statements, balance sheets, annual report, etc. to stock market.

6.2.Secondary Market

It is a market where shares issued in primary market can be traded. When the aforementioned process of listing comes to an end, share can be traded in secondary market for purposes like gaining profit out of it or curbing the losses. For this process of buying and selling, middlemen like stockbrokers or firms are needed as connection between stock exchange and investors[3].

Such transactions in secondary markets are termed as “trade” that enables the investors to sell and buy the shares between them at a mutually consented price. The investor can therefore quit the market after selling their shares.

7. Bombay Stock Exchange

The title of being first and the fastest working stock exchange in Asia is awarded to “BSE” an acronym used for Bombay Stock Exchange. Established in 1857, it still has retained the spot of leading exchange of India. It is one of the leading exchanges in India. BSE has contributed tremendously to the development of the Indian corporate wing over the past 140 years. It has established a clear capital generation platform and a busy stock trading and trading market for shared funds, derivatives and debt instruments. With 5500 plus companies listed in stock exchange, BSE has acquired the status of biggest stock exchange of globe on the parameters of listed companies. The total market capitalization of BSE-listed companies as of March 2015 is approximately USD 1.68 trillion. It is also one of the largest exchanges (fifth largest in March 2015) for index options trading.

BSE also provides capital market participants with a number of other services, such as market data services, settlement, clearing, risk management and education. BSE processes and structures are designed

[2] sebi.gov.in
[3] *Ibid.*

to broaden the Indian capital market, protect the integrity of the market, promote innovations and trigger market competitions. BSE is the world's second exchange to be accredited by certificate of ISO 9001:2000. BSE, by way of Central Depository Services Ltd. (CDSL), also provides depository services. The BSE share index, the S&P BSE SENSEX, is like instrument checking coming changes in the Indian stock market. A market-value-weighted index of 30 well-established and blue chip companies listed on the Bombay Stock Exchange is the S&P BSE SENSEX (also called BSE 30). The names of companies encompassed in the index are financially healthy company and are the market's most competitive trading firms.

8. National Stock Exchange

To give professional structure to Indian Capital Market, NSE was founded in 1994 in Bombay. It was a significant move in upgrading investors' facilities of trading and taking the Indian financial market up to the level of the international market. Trading functions automation brought productivity and accountability into the marketplace.

Establishment of NSE is the spark of Pherwani Committee. It was the powerful committee as named by the Government of India in 1991. NSE is registered as per the norms and under Companies Act, 1956. Few of its investors and promoters were QIC, IFCI, LIC, ICICI, SBI, etc. with IDBI as key promoter. The Board of Directors are responsible for taking key-policy decisions. The executive committee makes organizational decisions.

The main goal of the NSE is to provide investors with extensive national securities trading facilities. This is done by automated screen-based trading and automatic clearing and settlement facilities for post trade. Corporate traders with dealer networks along with computerized trading and short settlement times would be encouraged by the NSE.

NSE is categorized into two parts, one dealing with wholesale instruments of debt and the other with instruments of the stock market. The required clearing and settlement system would be performed by the electronic clearing and depository system (ECDS) set up by Stock Holding Corporation of India Limited (SHCIL).

Although NSE is funded by Financial Institutions, Mutual Funds, Trusts but it self-sustains by the levying of fees for memberships. The capital expenditure of 30 rupee Crores is funded by the admission of 1,000 members, each with an entry fee of 10 lakhs.

NSE is a corporation organized under the 1956 Companies Act. It is composed of and controlled by the Board of Directors. 50% of the Exchange's Board of Directors should be made up of experts from a cross-section of finance and business. It deals in equity shares and debt instruments on medium-sized securities.

NSE has launched itself in debt market. The market for debt is essentially dealing with government securities. It is altogether a different ring. For the first time in our world, debt instruments will be exchanged in order to become an active part of the nation's secondary market.

It has acquired assistance from the divisions of National Clearing and Settlement, SHCIL, and the Support Company for Securities Facilities. Advanced computer technologies have been referred for the processes of clearance and settlement. Also, better methods have been introduced to effectively release securities in market.

The NSE would provide investors with computerized national debt and stock exchange facilities. The NSE operates in two segments, the debt market and the stock market, respectively.

9. History of NSE

The Government of India decided to encourage the establishment of NSE on the basis of recommendations made by the High Powered Study Group on the Establishment of New Stock Exchanges following the outbreak of the 1992 security scam in which a BSE member, Harshad Mehta, was exposed to market manipulation. Providing fair access to investors from every possible corner of the country and ease of participating in stock market were the primary objectives[4].

NSE was founded in November 1992 as a tax-paying company where institutions like India Life Insurance Corporation, India State Bank, IFCI Limited, IDFC Limited and India Limited Stock Holding Corporation were primary investors. Under the Securities Contracts (Regulation) Act, 1956, it was recognized as a stock exchange in April 1993 and began operations in the Wholesale Debt Market (WDM) portion in June 1994. In November 1994, operations in the equity segment were launched, followed by the derivatives segment in June 2000.

NSE was the first stock exchange in India where three separate wings of individuals managed ownership, management and trading. Although ownership is owned by different financial institutions and banks, management is handled by independent professionals who are prevented from trading on the exchange directly or indirectly. Following this mechanism successfully eliminated the clash and scope of confusion between departments which was the reason of 1992 scam.

10. Working of Stock Market

There is no hidden rocket science behind how the stock market operates. It is quite easy. Stock market act like an auction house, where it enables buyers and sellers to bargain upon prices of shares and helps them in trading.

Stock market isn't independent and functions in consistency with other exchanges. It is a necessity for companies to display their shares on stock exchange. This mechanism is termed as IPO or Initial Public Offering. Interested investors make investment in the company by purchasing their shares which ultimately aids the companies to expand their businesses. Investors fulfill their roles by buying and selling the shares among themselves. On the other hand, Exchange is responsible to keep check upon supply and demand of stocks that are listed.

The component like supply and demand helps in estimating the securities price and conveys the standards at which buyers and sellers are ready to sell and purchase the shares issued.

To initiate the trade, it is a requisite that both buyer and seller shall agree for the same amount. Buyers announce a "bid". That bid amount is generally the highest price which buyers are prepared to pay. Also, the announced amount is typically lower in return than the amount "asked" by sellers. The aforesaid gap between amounts is denoted with the term "bid-ask spread".

May be for beginners, all this seems bit complex, but most calculations deciding prices are normally carried out by computer based mechanism. Practically, while investing in shares, an option of "bid-ask" will flash over the screens of both buyer and his broker. You will see the bid, ask, and bid-ask spread on the website of your broker while buying stock, but in many instances, the difference in minor scales is witnessed, and will not be of much interest to beginners and long-term investors.

11. Laws Regulating Security Market

11.1. SEBI Act

SEBI is an acronym used to denote Security Exchange Board of India. Earlier, when SEBI was given structure, it wasn't a statutory body. It gained the status of being "autonomous body" in the year 1992 with passing of SEBI Act, 1992, and conceded statutory power. By virtue of SEBI Act, 1992, SEBI acquires power to scrutinize actions of stock market. It is recognized as sole regulating body of stock market within Indian boundaries. The body mainly works to guard the interest of the investors, to protect and regulate the operations of security market of India. All the intermediaries who are participating in stock market now fall under the purview of SEBI regulation be it Indian or foreign nationals. Foreign investors need to follow distinct route to make investment in India by getting registered with DDPs[5].

---

[4] Regulations in India (www1.nseindia.com).

[5] Security Exchange Board of India Act, 1992

12. Functions of SEBI

12.1. Protective Function:

While performing the protective function SEBI ensures that to prohibit insider trading, unfair trade practices, educates its investors along with keeping a check upon price rigging. Insider trading refers to a situation where persons possessing direct confidential information with respect to the company by virtue of being employ or directors of the company, buys or sells the securities which might directly or indirectly negatively impact the security prices. As result, to guard the interest of public SEBI has put restriction on insiders to not to buy the shares of their own company. Also, SEBI is promoter of conducting trade in fair manner for which it has laid down some guidelines and is empowered to take action in case of carrying out unfair trade practices and keeps check and balance over price rigging activities. Price rigging is a practice of creating natural fluctuations in the prices of security which ultimately causes loss on the part of investors. Additionally, it focuses to educate people who are willing to invest via different mode including online and offline conferences[6].

12.2. Developmental Function

This function somewhere refers to technological advancements brought by SEBI to advance trade related activities in Stock Market. Technological advancement includes trading through internet, training of intermediaries, sale and purchase of share through DEMAT account. It has removed the compulsion upon underwriting so that the cost can be reduced.

12.3. Regulatory Function

Under this function, SEBI has established some rules and conducts to regulate the functioning of corporates as well as intermediaries to make their functions effective and smooth. Intermediaries now form the part of regulatory functions. SEBI regulates operations related to mutual funds, company takeovers. Audits of stock exchange are also performed by SEBI.

12.4. Depositories Act, 1996

The Act ushered the institution of depositories in stock markets. A depository has acquired the capacity to holds securities traded in stock exchange in electronic format. It corroborates smooth transferability of securities. Section 2(e) defines "depository". It means the institution where deposits are kept. The investors are provided with the facility of depositing their securities with depository by virtue of depository system. Board holds the power to provide the certificate of commencement of business to the depository when it is satisfied with the working of depository according to provision laid under the Act[7].

Securities are kept in digitalized forms with the depositories and it enables the free transfer of securities by only making entries in the books and not physical transfer of securities from one to other. The Act has successfully restricted the discretionary power of corporation while transferring the securities and initiated secure transfer of securities of public limited corporations. Also, other requirements like transfer deed are waived off under Companies Act.

12.5. Securities Contracts (Regulation) Act, 1956

This Act plays a very significant role in regulating the subjects of stock markets. The Act provides the procedure for stock exchanges to get themselves registered with government by fulfilling the requirements displayed in it. Section 4 elaborates this mechanism. SCRA implies that when government is satisfied with the proper functioning of stock markets which are desirous of securing registration, their conditions of working, laws- bylaws, then only it will let that stock exchange registered to ensure fair dealing and effective working of stock exchange[8].

---

[6] SEBI - Securities and Exchange Board of India (cleartax.in)

[7] S Samiksha, The Four Main Legislations Governing the Securities Markets of India

[8] *Ibid.*

The Act also empowers the government to interfere in matters relating to securities trading such as manner of entering and enforcing contracts among members, qualifications of members of stock exchange, listing of securities. All the actions are taken to restrain unwanted and bogus transactions.

12.6. Companies Act, 2013

Companies Act of 1956 became ineffective and outdated and 2013 Amendment Act was brought and enforced. The Act throws light upon various aspects with respect to operations of company, precisely issuing of company's shares and its allotment to investors including transfer from one to another. It lays the provisions relating to power and functions of members of the companies along with punishments. It brings out the procedures for public offerings to public of securities. The Act makes it mandatory for listed companies to disclose relevant information like annual turnover, their goodwill so that investors can have a glimpse of company in which they are about to invest.

The Amendment has enabled more transparency in ongoing operations of companies and its accountability which has resulted in gaining back the interest of public and has resulted in declining of frauds as compared to earlier committed frauds. Strict laws have been implemented curbing malpractices. Companies have made their rules and regulations of working consistent with the demands of Amendment Act, 2013.

12.7. Prevention of Money Laundering Act, 2002

The Act was framed to curb the activities relating money laundering. It also serves the primary purpose of confiscating the amount or property gained as an outcome of money laundering.

Money laundering is an act where an individual is held liable for acquiring, possessing or owning per se any return out of crime or if he furnishes his consent for committing transactions giving returns out of any crime or if he is indulged in concealing profits earned through crime irrespective of whether in or outside India.

The Act demarcates the means to forbid money laundering by imposing obligations upon companies, brokers, intermediaries to furnish such information as required, to maintain records of transactions and to give proper reports to Financial Intelligence Unit of India.

12.8. Indian Contract Act, 1872

All the contracts made for execution are governed by Indian Contract Act. The Act has dealt with concept like contracts of valid, voidable and void nature. Section 2 defines such contracts. Along with it, the mechanism to enforce, perform as well as how to enter it.

12.9. Indian Penal Code, 1860

IPC embraces the offences and provides punishment for the same. Some of the offences are related to contracts as well. Section 405 imbibes "criminal breach of trust". Section 415 talks that that if any person deceives and makes him to deliver any property or makes him to do anything when he is deceived, such act will be considered cheating. Section 463 is about "forgery". If any person creates false documents in any form with intention to cause damage will constitute forgery.

12.10. Foreign Exchange Management Act, 1999

FEMA was enacted to regulate foreign exchange market in India. Globalization has led people to invest in property without any geographical restrictions. The Act facilitates effective mechanism where NRIs of India can invest in Indian securities with ease. It also regulates things like types of investors, investing manner, purchase and sale price, etc.

CONCLUSION

Stock Market is a sector investing small amounts of investors into various other sectors resulting in boosting of economy thus, considered good component of economic growth. The stock market plays a crucial role in the growth of the region's business and trade, which ultimately has a significant effect on the country's economic system. In every economic structure, the stock market is seen as a very significant part of the financial sector. In addition, it plays a critical role in many emerging economies in the mobilization of resources. There are several variables that easily influence the working of the stock market.

The variance due to the various variables also reflects its effect on the economy. It is regarded that the conduct of the stock markets should be read out if one wishes to discover the country's economic structure. There is therefore a need to undertake current research in the above sense to explore the relationship that stock exchanges and financial factors share.

Looking into another aspect, it has been witnessed that even though there are laws to regulate the stock market and keep strict surveillance upon malpractices, there are still some loopholes because of which malpractices are taking place. Laws are required to be amended and strict punishment and liability shall be imposed in cases of infringement.