ABSTRACT

The origin of the stock market in India dates back to the end of the 18th Century after the enactment of the companies Act in 1850 which introduced the feature of limited liability. The Native Share and Stock Brokers' Association, now known as Bombay Stock Exchange (BSE) was formed in Bombay 1875. This was followed by the formation of association/exchange in Ahmadabad (1894), Calcutta (1908) and Madras (1937). In order to promote the orderly development of the stock market the central government introduced a comprehensive legislation called the Securities Contracts (Regulation) Act, 1956. According to section 2(3) of this Act the stock exchange has been defined as "anybody of individuals whether incorporated or not, constituted for the purpose of assisting, regulating and controlling the business of buying, selling or dealing in securities". This paper also discusses the policy and present scenario of Demutualization of stock market in India.

KEYWORDS: Demutualization, Stocks Exchange, Brokers, Global, Securities. Regulations.

DEMUTUALIZATION AND CORPORATIZATION OF STOCK EXCHANGE IN INDIA

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In India stock exchanges are free to establish themselves in any form of organisation, viz., a voluntary association of individuals, public limited company, company limited by guarantee, non-profit organisation etc. Three stock exchanges namely Bombay Stock Exchange, Ahmedabad Stock Exchange and Indore Stock Exchange have been organised as voluntary non profit making associations. This form is very suitable to the members as they can frame rules and regulations that suit them most. Membership can be acquired by inheritance or by purchase of a card of another member. The new card of membership can also be purchased from the stock exchange directly with the approval of other members.

Some exchange like those in Calcutta, Delhi, Madras, Bangalore etc. are organised as public limited companies. In this form, membership is acquired by purchasing the requisite qualifying shares. However, these shares are not freely transferable as in the case of a public limited company. The power of the members are derived from the memorandum of Association and Articles of Association of the company. The liability of the member is limited. However, the shares can be forfeited if the Governing Board of the stock exchange cancels the membership or of any person. The stock exchange being a service unit normally does not declare dividend for the share holders.

Some stock exchanges are in the form of companies limited by guarantee. In this form there is no share capital. The liability of the members is limited to the extent of the guaranteed amount mentioned in the memorandum of Association and Articles of Association of the company. The membership can be acquired if the Board of Directors permits the same by passing a resolution in this respect. Normally each member has one vote in this form of organisation.

In all these organisation forms stock exchanges are regarded as mutual associations of members. The members who provide broking services own, control and manage the exchanges. Moreover the exchanges are regarded as not-for-profit organisation. Until 1988, the stock exchanges were more or less self-regulatory organisations supervised by the Ministry of Finance under SCRA. However, the stock exchanges had not been discharging their self-regulatory role well as a result of which malpractices had crept into trading adversely affecting the interests of the investors. In other words, the brokers who trade collectively own and run these exchanges. The ownership and managerial rights of the brokers often led to a conflict of interests where in the interest of brokers was preserved over that of the investors. Instances of price rigging, recurring payment crisis on stock exchanges and misuse of official position by office bearers have been unearthed in the last few years.

Several committees examined and made recommendations to reform the organisations of the stock exchanges. G.S. Patel Committee (1985), L.C. Gupta Committee (1991), Pherwani Committee (1991), G.S. Patel Committee (1995), Verma Committee (1997) are some of these committees. The Securities and Exchange Board of India (SEBI) has been set up in 1988 to ensure that stock exchanges discharge their self-regulatory role properly. To prevent malpractices in trading and to protect the rights of investors, the SEBI has assumed the monitoring function, requiring brokers to be registered and stock exchanges to report on their activities.

The Government has approved the scheme of demutualization and corporatization of stock exchanges in India in recent years after the study group constituted under the chairmanship of justice M.H. Kania has strongly recommended the same. It should be noted that demutualisation is the process by which any “member-owned organisation” can become a “share –share-holder owned” company. Through demutualization a stock exchange becomes a corporate entity, changing from a non-profit-making company to a profit making and tax-paying company.

Demutualization separates the ownership and control of stock exchanges from the trading rights of its members. This reduces the conflict of interest between the exchange and the brokers and the chances of brokers using the stock exchanges for personal gains. With demutualization stock exchanges will have access to more funds for investment in technology, mergers with and acquisition of other exchanges, and for strategic alliances with other exchanges. Members of the stock exchange also benefit by demutualization as their assets become liquid and they get a share of the profits made by the exchange through dividends.

Demutualization makes operations of the stock exchange transparent which facilitates better governance. The benefit of professional management is another advantage claimed by the demutualized and corporatized stock exchanges compared to the member-owned organizations. Demutualized and corporatized stock exchanges allow for greater flexibility in management. This is because, a public-ity held company is better equipped to respond to changes as compared to a closely held and a mutually owned organization. In addition, a company can spin-off its subsidiaries, get into mergers and acquisition, raise funds etc.

To introduce demutualization and corporatization in India stock exchanges Kania study group was appointed by SEBI. The main recommendations of the Kania Group can now be mentioned.

(i) The stock exchanges which are set up as association of persons and those which are set up as companies limited by guarantee be converted into companies limited by shares. A common model for corporatization and demutualization be adopted for all stock exchanges. The SCRA 1956 need to be amended to provide that a stock exchange should be a company incorporated under the Companies Act.

(ii) As corporatization and demutualization of a stock exchange is essentially a conversion from a not-for-profit entity to a for-profit company, and would result in a distribution of assets, the Income Tax Act should be amended, if necessary, so that the past profits of a stock exchange should not be taxed when its character changes. In other words, accumulated reserves of the stock exchanges as on the day of corporatization should not be taxed. However, there would be no objection to taxation of these reserves in the hands of shareholders when these are distributed to them as dividend at the net applicable tax rate. All future profits of the stock exchange after it becomes a for-profit company may be taxed.

(iii) A statutory provision should be made in the Income Tax Act, so that the issue of shares trading rights in lieu of cards should not be regarded as transfer within the meaning of Section 47(xii) of the Income Tax Act. The bye-laws, rules and articles of a stock exchange should be amended to provide for the allotment of shares and trading rights to its members upon corporatization and demutualization.

(iv) Necessary provision should also be made in the Indian Stamp Act and the Sales Tax Laws to exempt from stamp duty and sales tax, the transfer of assets from the mutual stock exchange and the issuance of shares by the new demutualization for-profit company, formed of demutualization.
Apart from corporatization and demutualization what is needed is to create an integrated network of regional stock exchanges and to set up a central trading system for the regional stock exchanges.

REFERENCES: