DEMUTUALISATION OF INDIAN STOCK EXCHANGES: A CRITICAL EVALUATION AND SOME SUGGESTIONS

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1. The process of demutualising all the broker-run exchanges in India actually started with the Bombay Stock Exchange which was demutualised in August 2005. In the U.K., in March 2000, the London Stock Exchange got demutualised. In the case of both these exchanges, the legal process was broadly the same: conversion from a not-for-profit mutual entity, i.e., an association of stockbrokers, into a for-profit public limited company. However, the underlying purpose of demutualisation in India is absolutely different from that in the U.K.

2. In India, demutualisation was *mandated by the government* as a regulatory measure directed at ending the brokers' control over the exchanges. By contrast, the London Stock Exchange's demutualisation was entirely its own *voluntary decision*, aimed at developing its business in the fast changing and globalising world. This step was expected to improve its international competitiveness, provide greater flexibility, facilitate speedier decision-making, and enable it to form international alliances, as and when necessary. In fact, the voluntary route is the international norm.

3. The Indian government's scheme of demutualising stock exchanges has certain noteworthy but somewhat rigid features mentioned below. *One*, the representation of stockbrokers on the governing board of each exchange is restricted to a maximum of 1/4th of the board's strength, the remaining 3/4ths of the directors being appointed in the manner specified by SEBI from time to time. *Two***,** the aggregate shareholding of broker-shareholders (i.e. shareholders having trading rights as brokers) is limited to a maximum of 49% of the exchange's equity capital. *Three,* a minimum of 51% of the equity capital is to be held at all times by public other than broker-shareholders. And *four,* no broker-shareholder is allowed to have more than 5% voting rights.

4. The demutualisation scheme is individual exchange-based scheme, prescribing a mandatory model. The exchanges, which are unable to comply, will have to close down. Thus, *demutualisation is bound to affect the over-all structure of India's exchanges*. Most probably, only 3–4 of our 23 exchanges will survive. The authorities have said nothing about what kind of post-demutualisation structure will be the best in the Indian situation. Our discussion will specially focus on this aspect.

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5. Regarding the stipulation that atleast 51% of the demutualised exchange's equity capital should always be held by the 'public' shareholders, an important issue is whether the exchange can take a strategic partner and how much equity can the partner hold. There is no agreed official view on this extremely important matter. Having a strategic partner can bring in specialised knowledge and contribute to the exchange's long-term development.

6. An indirect effect of demutualisation is to make the stock exchange managements think afresh. This releases a new energy and can revitalize our stock exchange system.

7. Our capital market authorities need to take a definite view on the desired structure of stock exchanges in the post-demutualisation period. I suggest that it should be a 3-exchange structure, comprising two competing exchanges (NSE and BSE) for shares of large companies and one exchange with quote-driven system for shares of SMEs.

See also the Economic Times dated 20.11.06.