OVER THE COUNTER EXCHANGE OF INDIA (OTCEI)

A Parallel Exchange System

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Introduction

The Indian capital Market has witnessed a phenomenal growth during the 1980s. As a result, the investment consciousness about the industrial securities, symbolised by growing financialisation of the household sector's savings, is spreading fast. The number of investors in the country is estimated to have increased from 8 million in 1986 to 15 million in 1991; the number of stock exchanges from 15 in 1986 to 22 in 1991; and the number of listed companies from 4,744 in 1986 to 6,500 in 1991. However, there is also a recognition of the fact that the stock markets are not able to serve the investors (especially the small investors) to their satisfaction.

Problems of Potential Investors

The Indian stock markets have not yet been able to develop the requisite degree of liquidity in all the listed securities. In this context, it is worth pointing out that the Pherwani Committee Report, 1991 (Pherwani, 1991) adversely commented on the poor liquidity of both equity and debenture scrips. For instance, in the Bombay Stock Exchange, out of 2,275 companies listed as on March 31, 1989, the daily transactions were carried out in only about 250 to 300 companies, while weekly transactions in another 500-600 companies whereas other scrips remained almost dormant. That is why the Indian stock markets are described as a peculiar amalgam of high volatility in respect of few scrips and low liquidity in respect of a vast majority of them.

Lack of transparency of transactions is another major shortcoming of stock exchanges. An investor is hardly allowed to know the actual rate of transaction, he being forced to be content with a statement of net to pay in respect of purchases and net to receive with regard to sales, the brokerage

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amount being added to the former and deducted from the latter, without indicating the quantum of brokerage. More often than not, the rate of transaction given to the investor is the highest in the case of purchases and the lowest in respect of sales of the recorded transactions of the day.

Longer settlement period poses another serious problem to the investors. For instance, an investor who has sold shares through his broker at the beginning of the settlement period can get payment, at the earliest, only after four to five weeks. For a buyer, additional problems arise when the delivery turns out to be bad for a variety of reasons, a typical one being signature differences on verification by the company.

Another problem that the small investors face relates to odd lot holding of shares. The problems in disposing of the odd lot holdings are many. In the first place, it is difficult to find a buyer for odd lots and much more for small holdings like 1, 2 or 3 shares. Moreover, the odd lots are traded only once a week and not much attention is given to their disposal or buying. Even if a buyer is found, the consideration price is much below the rate quoted for a marketable lot.

There is also a complaint about the slow growth in the number of market operators/brokers vis-a-vis the growth in the number of listed companies, the number of investors, and the volume of trading. Moreover, many of the investors are dissatisfied with the quality of brokerage services received. The reason: in floor based exchanges, the physical limitation of space on the trading floor rather than the investors' need for brokerage services determines whether and to what extent the supply of authorised brokerage services can be increased (Gupta, 1992).

One of the inter-market trading problems faced by the investors is the mismatch between primary market development and secondary market trading arrangements. At present, while the primary market is nationwide, the secondary market arrangements have remained localised and fragmented. Apart from this, stock exchanges in the secondary market do not have uniform settlement, delivery and payment system, and there is no national clearing system. The exchanges are not integrated into a single, unified, national market.

The Emergence of OTCEI

The problems faced by the potential investors, as enumerated above, in buying and selling industrial securities have been engaging the attention of various Committees appointed by the Government of India on Stock Exchange Reforms. In this context, in October 1988, the then Finance Minister, S.B. Chavan, announced the Government's decision to set up an 'Over-the-Counter Market' (OTC market) for trading of shares to safeguard the interests of investors. The market will impart liquidity to shares, increase transperancy of operations and so on. The OTC market also intends to create liquidity for the shares of small and comparatively new companies which are unable to offer their shares to the public in view of the Stock Exchanges' listing requirement that only such companies can seek enlistment thereon which have a minimum issued equity of Rs. 3 crore and minimum public offer of Rs. 1.8 crore. Thus, OTC market offers greater potential to companies and investors alike, providing a much needed second-tier segment of the Indian securities market.

In the beginning, the term OTC market was not properly defined, and in many quarters was used as a blanket phrase covering all unlisted stocks not dealt with on the Stock Exchanges. This term has remained down the passage of time, and is the origin of the present-day OTC market, established as a major 'tier' route to equity finance comprising a loosely organised, decentralised network of negotiated markets. In contrast to the centralised trading floors of the traditional stock exchanges, the OTC Exchange market is a floorless market. It does not have an identified single physical market place. That is, the market is spread across the country through numerous counters of the operators recognised by the Exchange. Trading in OTC Exchange is negotiated unlike the auction trading in stock exchanges. The prices of securities are negotiated between buyers and sellers directly or indirectly through brokers. OTC Exchange is thus a parallel exchange system operating without a traditional trading floor; it is automated, virtually paper free and a convenient and cost effective means of raising finance, spread across the country through the numerous well connected counters of the operators recognised by the OTC Exchange.

Over-the-Counter Exchange of India (OTCEI) was constituted in August 1989, as a company under Section 25 of the Companies Act 1956. By a Government Notification, it has been approved as a recognised Exchange under Section 4 of the Securities Contract (Regulation) Act, 1956 and hence all companies listed on OTCEI will enjoy the same status with reference to taxes and interest rate on borrowings. OTCEI, presently confined to Bombay, is to be gradually extended to other important financial centres of the country.

OTCEI has an authorised capital of Rs. 10 crore and a paid up capital of Rs. 8 crore. Industrial Credit and Investment Corporation of India (ICICI), Unit Trust of India (UTI) are the main promoters with a 20 per cent stake each, followed by Industrial Development Bank of India (IDBI) with 17 per cent and State Bank of India Capital Markets Ltd. (SBICAP) with 11 per cent, and General Insurance Corporation of India (GIC), Life Insurance Corporation of India (LIC), Industrial Finance Corporation of India, (IFCI) and Canbank Financial Services Ltd. (CANFINA), all with 8 per cent stake each. OTCEI Governing Board at present has 10 members out of which 8 are from promoter institutions of OTCEI.

Constituents of OTCEI

There are five constituents of OTCEI:

(a) companies planning to raise finance and to get listed on OTCEI;
(b) members of OTCEI, who will act as sponsors to companies raising

finance through OTCEI;

(c) market makers – both members and dealers. They are licensed dealers in securities, entitled to act in a dual capacity i.e. as a principal (like a stock jobber) and as an agent (like a stockbroker). Their major job is to quote two way prices: a buying (offer) price and a selling (bid) price. These are net prices, and no commission is charged to the investors. They obtain their remuneration from the spread between the price they pay for shares and the price at which they sell them;

(d) licensed dealers as appointed by OTCEI. They may act as either market makers for a security or as a connecting link between individual investors and market makers similar to the brokers in the stock exchanges and charge a commission for their services; and

(e) registered investors.

Eligibility Criterion for Listing

In order to be eligible for listing on OTCEI,

(a) a company must have a minimum of issued share capital of Rs. 30 lakh subject to a minimum public offer of Rs. 20 lakh in face value;

(b) a company having issued equity share capital of Rs. 30 lakh but less than Rs. 3 crore must offer 40 per cent of the issued capital to the public; and

(c) a company having issued equity share capital of more than Rs. 3 crore but less than Rs. 25 crore, must offer 60 per cent of the issued capital to the public.

The following companies are not eligible for listing on OTCEI:

(a) a company having issued share capital of more than Rs. 25 crore;

(b) a company engaged in investment, finance and leasing business etc.;

(c) a company already listed on any other recognised Stock Exchange in India; and

(d) MRTP (Monopolistic and Restrictive Trade Practices) and FERA (Foreign Exchange Regulation Act) companies having issued share capital less than Rs. 3 crore.

Procedure for Listing

For any security to be listed on the OTCEI, the project of the company must be appraised by a sponsor, who has to be a member of the OTCEI. The role of a sponsor is to appraise and evaluate the project of the company, value the shares to decide premium, sponsor the security to other market participants, arrange for additional market maker, offer the scrip to the public and be a compulsory market maker for the security for a minimum period of 3 years. At present, there are 30 members comprising of public sector financial institutions, banks, mutual funds, merchant bankers and venture capital funds.

What is traded on OTCEI?

OTC market is called a scripless market. The share certificates are not issued to the public for actual trading in the market but are deposited by the respective companies with the Registrar to the Issue who acts as the custodian of the share certificates. Each time an investor purchases shares, he would be issued a 'Counter Receipt' (CR) which would be the constructive proof of the ownership of the specified shares mentioned on the receipt. Similarly, at the time of sale of shares,the investor would be issued a 'Sale Confirmation Slip' (SCS) in exchange for the CR earlier issued to him. Thus, it is not the share certificate which is actually traded on the OTCEI, it is the CR and SCS which are traded on the exchange. These are tradeable documents and contain (a) name of investor, company, number of shares, name and address of the Registrar; (b) price, commission, date, time of transaction; (c) investor's signature, his bank name and account number; and (d) name, code number and signature of the issuing counter.

Four copies of each are prepared and are held by four parties namely investor, dealer's counter, OTCEI and the Registrar.

Market Mechanism

What distinguishes the OTC market from the first tier of stock market is that it functions as a secondary market and a primary market as well. In the primary market there are two ways of making public offer. Under 'Direct Offer', a company can offer its shares directly to the public after getting it sponsored by a sponsor. The *modus operandi* is: the application forms and the prospectus shall be made available at each recognised dealer's counter. The investor wishing to apply has to fill up the form and submit the same to the counter alongwith the cheque. He will get a temporary receipt that shows the payment, from the counter. At the close of the subscription period, the applications will be sent to the Registrar and after getting his approval, the investor will be issued a CR. In case the issue remains undersubscribed, the sponsor has to come forward and subscribe the unsubscribed portion (Terdal, 1992).

Under 'Indirect Offer', all the shares are purchased by the sponsor in the first instance and offered to the public in the second instance. Here the pricing of the shares will be decided by the sponsor at the time of subscribing as well as at the time of off-loading the shares.

In OTC market, a secondary market transaction can be effected in two ways: between an investor and a market maker, and between an investor and a licensed dealer. A unique feature of OTC market is that investors are able to buy and sell shares at negotiated prices beamed on the PTI OTC Scan which thereby helps achieve the accuracy in buying and selling prices.

An investor wishing to deal in any particular scrip, first of all, has to find out which market maker and/or licensed dealer's counter actually deals in the market in that scrip and then has to make a call to obtain the quoted prices. The dealer will be displaying the quantum of scrips he is holding, the market lots and the bid and the offer prices. Once a satisfactory buying bargain has been struck, the counter will prepare a transfer deed and forward the same to the Registrar for updating in exchange for the payment received from the investor. As soon as the transfer deed is updated and the cheque is cleared, the investor will be issued a CR.

At the time of selling the scrip, the investor again has to approach a dealer's counter to find out the quoted prices. Once a selling bargain is struck, the investor has to produce the CR and the Transfer Deed to the counter against which he will be issued an SCS, finally to be exchanged for a cheque (Terdal, 1992).

A single transaction, either buying or selling, takes a period of about seven days as against a period of about six months for its completion in stock exchanges.

OTCEI has started trading operations, albeit in a modest way. On October 1, 1992, two days after it was officially opened, OTCEI started trading in Vasundhara Rasayans Ltd., the first scrip listed on the Exchange. The second scrip listed on the Exchange is that of Co-Nick Alloys Ltd. There were 400 deals recorded during the first month and the total turnover was nearly Rs. 17 lakh and trading took place in 44,000 shares (*Times of India* Nov. 4, 1992).

But, OTCEI is bedevilled by teething troubles. Being an Exchange that deals exclusively over the telephone, dealers find it tough to get through to place orders. However, this could get sorted out once the OTC market gets its own lines for members and dealers and its trading volume increases.

NOTES AND REFERENCES

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