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Dematerialisation of Securities in Indian Capital Market; A Paradigm Shift through Depository System

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Abstract

Dematerialization has initiated a new trend in securities trading and settlement. Indian capital market has embraced technological sophistication by permitting electronic trading in securities. Depositors Act, 1996 has facilitated the setting up of depositories and dematerialization of securities. This paper attempts to evaluate the progress of dematerialization in India. For the study, data has been used that of the National Stock Exchange of India Ltd. (NSE), the largest stock exchange in India.

Keywords: Dematerialisation, Depository Participants, SEBI, NSDL & Indian capital market

Introduction

The capital market is the backbone of any country’s economy. It pools resources and channelizes them into investible opportunities. Such an intermediation function is carried out through financial instruments. However, dealing with financial instruments in physical form caused a lot of problems. For trading and settlement, physical securities had to be transferred from the seller to seller’s broker, from the seller’s broker to the buyer’s broker, and from the buyer’s broker to the buyer. This was a time-consuming process involving extra costs such as stamp duty etc. Forgery and theft of such certificates were also common. Holding physical documents also led to their mutilation and damage. Long settlement delay after effecting a transaction reduced the liquidity of the market. Hence in 1996, Govt. of India enacted the Depositories Act, 1996. The Act paved the way for setting up of the Depositories.

Depository System

In a Depository System, a depository plays the central role. A depository is an organization where the securities of investors are held in electronic data form. It is like a bank for securities. It reaches out to the general investors through its agents known as Depository Participants (DPs). Investors who are intending to avail depository services have to open a Demat Account with the DP, who, in turn, will communicate the same with the Depository. An investor avails the depository services through a DP. The depository offers various services. Among others, dematerialization is a prominent one. Dematerialization is a process whereby the securities held in physical form are converted into their book-entry form (electronic form). As per Securities and Exchange Board of India (SEBI) Rules, to trade in securities, it is compulsory to dematerialize. However, the investors have an option to hold securities in physical form. (In addition to dematerialization, a depository offers services like rematerialization, i.e., reconverting securities in the electronic form into physical form, pledge /

hypothecation of dematerialized securities, distribution of corporate benefits (like dividend, bonus shares, etc.) for the investors. In India, as of today, two depositories are rendering depository services viz. NSDL (National Securities Depository Ltd) and CDSL (Central Depository Services of India) Ltd.)

Dematerialized trading and settlement offers various advantages to investors.

1. Elimination of bad delivers – As the dematerialization process eliminates both the physical share certificates and the need for transfer deed, a question of bad delivery does not arise.
2. Elimination of all risks associated with the physical receipt such as the risk of theft of stock, mutilation, loss of certificates during movement from the Registrars. These expose the investor to the cost of obtaining duplicate certificates, advertisements, etc.
3. There is no stamp duty for transfer of securities in the depository system.
4. The electronic form of settlement enables us to have a faster settlement cycle in the market.
5. A depository provides for direct credit for non-cash corporate entitlements like rights, bonus shares, etc. to the investors' account.

Table 1 shows that an investor saves 65-100 basic points in case of Demat shares without transacting and saves a higher amount, i.e., 140-445 essential points when transacting ten times a year in case of Demat shares. Dematerialization in Indian capital market is analyzed as follow:

Table 2 shows the progress of dematerialization at NSDL and CDSL. The table shows that DPs live under NSDL have increased gradually from 24 to 214 over the period from 1996-97 to 2003-2004.

An increase can be seen at CDSL, which started its operations in 1999-00. The number of DP locations also has increased from 24 (1996-97) to 1719 (2003-04). An increase can be seen at CDSL also. The dematerialized quantity has grown substantially to 8369 crore shares at NSDL by 2003-04, while at CDSL, it was 1401 crore shares.

Dematerialization enables trading and settlement of transactions in securities in electronic form. Table 3 shows the situation of dematerialized securities trading in India. (Cash seg of NSE)

Table 3 shows that the number of companies listed increased gradually from 648 to 909 over the period 1998-99 to 2003-04. During the period number of trades also increased, from 546 lakhs to 3780 lakhs. The mean traded quantity was 3,48,890 lakhs while the mean turnover amounted to Rs. 8, 03,954 crores. During the period, Demat securities traded has increased from 8542 lakhs to 713301 lakhs. Such a phenomenal increase is also seen in Demat turnover, i.e., from Rs. 23818 crores to Rs.10,99,534 crores. The mean Demat securities traded was 304,100 lakhs, while mean Demat turnover was 705041 crores. In short, trading in Demat mode has increased substantially both in terms of quantity and value over the period.

Table 4 shows the settlement statistics for the cash segment of NSE, the largest stock exchange in India. The table shows that over the period from 1998-99 to 2003-04, the delivered quantity has been increased from 27991 lakhs to 174538 lakhs, while the amount delivered increased 66204 lakhs to 220341 lakh; given volume in Demat mode increased from 6179 lakhs to 174538 lakhs. While the value increased from Rs.11571 crores to Rs. 220341 crores during the period. By the year 2003 –04, the entire settlement (100%) effected in Demat mode.

Table 1: Comparison of cost for the long term Investor who buys and trade shares worth Rs.10000 (Figures in basic points)

	Without transacting			With transacting 10 times/year		
	Physical shares	Demat shares	Savings	Physical shares	Demat shares	Savings
Brokerage	75-100	50-75	25-50	750-100	500-750	250-500
Stamp duty	50	-	50	-	-	-
Postal charges	10-30	-	10-30	-	-	-
Company objection (notarization etc.)	10-30	-	10-30	-	-	-

Settlement charges	-	5-10	-(5-10)		50-100	-(50-100)
Custody (5 years)	-	25-50	-(25-50)		5-10	-(5-10)
Total	-	-	65-100	-	-	140-445

Source: An Investors Guide to depository NSDL

Table 2: Progress of Dematerialisation at NSDL and CDSL

At the end of the period	DPs- Live	DPs- Locations	Demat Quantity (shares in Crore)	DPs Locations	Demat Quantity (shares in Crore)
1996-97	24	24	2	NA	NA
1997-98	49	200	176	NA	NA
1998-99	84	750	711	NA	NA
1999-00	124	1425	1550	NA	NA
2000-01	156	1896	3721	132	192
2001-02	212	1648	5167	181	482
2002-03	213	1718	6876	212	821
2003-04	214	1719	8369	219	1401

NA: Not Available; Source: NSDL and CDSL

Table 3: Cash Segment of NSE

Month	No. of companies listed*	No. of Trades (lakh)	Traded Quantity (Lakh)	Turnover (Rs. crore)	Demat Securities Traded (Lakh)	Demat Turnover (Rs. crore)	Market Capitalisation (Rs. Crore*)
1998-99	648	546	165327	414474	8542	23818	491175
1999-00	720	984	242704	839052	153772	711706	1020426
2000-01	785	1676	329536	1339510	307222	1264337	657847
2001-02	793	1753	278408	513167	277717	512866	636861
2002-03	818	2398	364065	617989	364049	617984	537133
2003-04	909	3780	713301	1099534	713301	1099534	1120976

NA: Not Available; *At the end of the period; Source: NSE

Table 4: Settlement Statistics for Cash Segment of NSE

Month / Year	Delivered quantity (Lakhs)	Delivered value (Rs. Crore)	Delivered quantity in Demat mode (Lakhs)	% of Demat Delivered Quantity to Total Delivered Quantity	Delivered value in Demat Mode (Rs. crore)	% of Demat delivered value to Total Delivered value
1998-99	27991	66204	6179	22.1	11571	17.5
1999-00	48713	82607	26063	53.5	67047	81.2
2000-01	50203	106277	47257	94.1	104246	98.1
2001-02	59299	71767	59169	99.8	71688	99.9
2002-03	82305	87895	82305	100	87895	100
2003-04	174538	220341	174538	100	220341	100

Source: NSE

Conclusion

With the enactment of the Depositories Act, 1996, the Govt. of India has initiated a new paradigm in the

capital market in the form of a Depository System. The system helps to trade and settle securities transactions on the electronic form. Electronic

trading enables investors to have a transparent and hassle-free dealing in securities. The progress of dematerialization, as revealed by the paper, shows that the Indian capital market has adapted to the new system gradually. Though the dematerialization is optional for an investor holding the securities, the trading and settlement have increased substantially in electronic form. The improved securities' dealing mechanism brought-in by the Depository System will, indeed, help the country to meet the global standards and infrastructural requirements. This will help to attract more foreign investors into the country. Having accepted the modern way of securities dealing, it signals for a few initiatives like dematerialized dealing with other documents, etc. Necessary amendments also should be made for the purpose.

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