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DEMUTUALIZATION OF STOCK EXCHANGES A COMPARISON OF NSE MODEL WITH INTERNATIONAL MODEL

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INTRODUCTION

The Stock Exchanges represents the market place for buying and selling of securities and ensuring liquidity in the interest of the investor. In the absence of the Stock Exchanges the people with savings would hardly invest in corporate securities and they would be starved of liquidity. Historically, Stock Exchanges were mutual organizations, managed by the members located in a single city with huge dealer population. With the twin forces of globalization and technology advancement, the world order is changing. The stock markets worldwide are experiencing increasing competition. Unification is happening right before our eyes and soon there will be single unified "world stock market".

CONCEPT OF DEMUTUALIZATION

Demutualization refers to the conversion of a "not for – profit" organization into a "for profit" company. It means the transition from "mutually owned association" to a "company owned by shareholders". Further the company may choose to be listed or an unlisted, closely held public company.

HOW IS AN EXCHANGE DEMUTALISED?

- The Exchange values all its assets including the value of seats (membership license) and arrives at a total value.
- This value is divided into shares and offered to the public.
- Later, the shares are listed on the Stock Exchange itself and the funds are secured by selling the shares among the members of the Exchange as payment for their seats.
- If the company is not being listed, the shares may be offered to its members.

WHY DO EXCHANGES DEMUTALISE?

The reasons for demutualization of stock exchanges are as follows

- Corporate structure is the goal of demutualization and provides management more flexibility.
- A company is better equipped to respond to changes when compared to a closely held mutually owned organization.
- A company can spin-off its subsidiaries, get into mergers and acquisitions, raise funds.

EXAMPLE

National Stock Exchange has spun of its wholly owned subsidiaries like National Securities Clearing Corporation and more recently NSE.IT into a dedicated Info-tech Company.

ARGUMENTS IN FAVOUR OF DEMUTUALIZATION

The following are important arguments in favour of demutualization.

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A) BEYOND SELFISH MOTIVES

Exchanges owned by members tend to work in the interest of members alone. Divisions of ownership between members and outsiders can lead to a balanced approach taking into consideration the interest of other players.

B) COPE WITH COMPETITION

Alternate Trading System (ATS) and Electronic Communication Network (ECN) provide cheap and efficient access to quoted stocks unlike traditional Stock Exchanges. To cope with competition, Exchanges require funds. While membership owned Exchanges have limitations in raising funds, publicly owned Exchanges can tap capital markets.

C) PROFESSIONALISM

Publicly owned Exchanges are more professional and lead to transparency in dealings, accountability and market discipline.

THE FEATURES OF A MUTUALISED AND DEMUTUALIZED STOCK EXCHANGES

The Mutualised Stock Exchanges and Demutualised Stock Exchanges differ in many aspects. Some of the common aspects of both the Stock Exchanges are taken into account for the purpose of differentiating their significance.

FEATURES OF MUTUALISED AND DEMUTUALISED STOCK EXCHANGES

S.No.	Features	Mutualised SEs	Demutualised SEs
1	Owners	Stock Brokers (owners, customers, directors are the same people)	Share Holders (owners, customers, directors are three different groups)
2	Nature	Not for Profit	For profit
3	Returns to the members	In the form of low trading cost or improved service	In the form of dividend and capital gains
4	Role of the Board of Directors	Plays an active role in the managerial matters	Plays an active role in the policy issues
5	Scope of raising large amounts of low cost of capital	Low	High
6	Sources of Capital	From Associations or Guarantee limited Companies	From Public Financial Institutions
7	Balance of Power	In favour of members	In favour of Stake holders
8	Mergers & Alliance	Not possible	Possible

A COMPARISON OF THE NSE MODEL AND THE INTERNATIONAL MODEL OF DEMUTUALISED STOCK EXCHANGES

For the purpose of comparing the NSE Model with International Model of Demutualised Stock Exchanges, TEN comparators are taken. They are as follows.

S.No.	Comparators	International Model	National Stock Exchange Model
1	Legal Structure	Company	Company
2	For Profit / Not for Profit	For profit company	For profit company
3	Ownership structure	Owned by Shareholders, which includes brokers.	Owned by Shareholders, which are financial institutions, which also have broking firms as subsidiaries.
4	Listing	Several Stock Exchanges are listed on themselves after Initial Public Offer	Not a listed company. No Initial Public Offer made.
5	Ceilings on shareholding	Mostly 5% of voting rights for a single shareholder.	No ceiling
6	Segregation of ownership, trading rights and management	These are segregated. To become a member of the demutualised Stock Exchange, it is not necessary to own shares in the company. Thus, members may or may not be shareholders and members who own shares may sell off their trading rights and all shareholders are not necessarily members.	These are segregated. The trading rights and ownership are segregated. The broking firms are not shareholders.
7	Board structure	The Governing Board comprises of directors who are elected by shareholders. Some of the directors are brokers but majority don't have stock broking background.	The Board comprises of representatives of shareholders, academics, charted accountants, legal experts etc. To these, three directors are nominated by SEBI and three directors are public representatives approved by SEBI.
8	Fiscal benefits	As mutual entities, stock exchanges enjoyed fiscal benefits prior to demutualization, but when converted into, profit companies, these are taxed.	NSE was set up demutualised for profit Company and is taxed. So the question of fiscal benefit prior to demutualization does not arise.

S.No.	Comparators	International Model	National Stock Exchange Model
9	Transfer of assets	Assets were transferred from the mutual entity to the for-profit company and shares were given to the members in lieu of the ownership in the old entity. There was no cash consideration. Since an Initial Public Offer (IPO) was also made in many cases, the valuation of the shares is done by the market and no separate valuation exercise was required as for example in case of London Stock Exchange where a bonus issue was made.	The question of transfer of assets did not arise because the institutions set up NSE as a demutualised company itself.
10	Enactment of legislation to give effect to demutualization	In several countries a separate legislation was necessary as in the case of Australia, Hong Kong, Toronto and Singapore. In several others, no legislation was necessary as in the case of UK.	Not applicable as NSE was set up as a demutualised Company.

Source: NSE news, 2001.

CONCLUSION

The world experience shows that the volume of trade dealt with by the Stock Exchanges is large due to use of demutualisation model. However many Indian Exchanges are reluctant to demutalise for fear of losing their identify and having to pay huge taxes on conversion. It is said that 5 years from now, the business of trading of shares will be radically different. Many old Stock Exchanges will cease to exist. This transition can be sensed from the launch of a new trading system at regular intervals. As Stock Market is referred to as the nerve centre of the Capital Market reflecting the health of the country's economy as a whole, the future of the capital market lies in the Demutualisation of the Stock Exchanges.