PHOTOS: SANJAY BORADE

Kumar: we are confident

The fallen Angel

The Metropolitan Stock Exchange plans to soar again

Can a moribund stock exchange, which has once fallen from grace, rise again? While academicians argue that in theory it can, in practical terms it is difficult – at least in India. The regional stock exchanges in India collectively contributed to as much as 45 per cent of the total turnover, in the mid-1990s. In 2001-02, their contribution was down to 29 per cent and thereafter they virtually just disappeared off the radar of investors. In 2003, in *Stock Market Review*, a publication of BSE, M.R. Mayya, who had headed BSE during the crisis years of the 1990s, noted that the uniformity of trading cycles, which reduced arbitrage opportunities; banning of *badla* (a precursor of F&O); as also the compulsory rolling cycles, had contributed to the downfall of the regional exchanges. The technology-driven National Stock Exchange, which had rapidly increased its geographical footprint on a pan-India level, also made a big dent in the market share and profits of the Bombay Stock Exchange, which is even now, despite its investment in superior technology and rapid execution prowess, behind the NSE.

While technology was a big disruptor and spelt the death knell of the regional stock exchanges, the Integrated Stock Exchange, which had 19 stock exchanges as its promoters, headed by Mayya, failed to take off. As did OTCEI, an exchange which was created for small and medium companies, ahead of listing on the main exchange. BSE is the only exchange till date, which has been partially successful after its transformation in recent years (*see* Business India, *dated February 17-March 2, 2014*) in competition with the NSE.

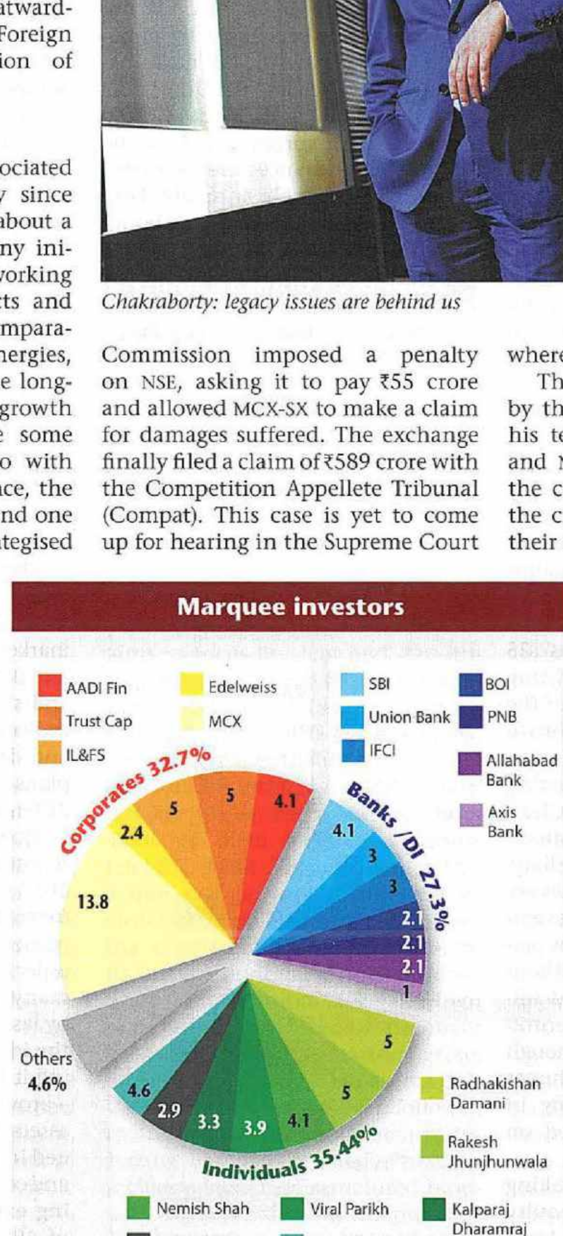
Notwithstanding all odds stacked against it, the new management at the Metropolitan Stock Exchange of India Limited (MSEI), formerly MCX-SX, is optimistic about reviving the stock exchange. "We are confident that it can be done," says Udai Kumar, 57, MD & CEO. Kumar, who was appointed in February 2016, has over three decades of experience in the financial markets in the fields of stock market administration, M&A, and fund-raising, amongst other areas, having served in organisations such as Morgan Stanley, JM Financial, Centrum, Fortune Financial, etc. He was also MD, Integrated Stock Exchange of India. His last job was as MD & CEO, MCSEI Clearing Corporation. Udai Kumar and his team members Abhijit Chakraborty, COO-Strategy & Development, have put a turnaround plan in place, which has met with the approval of the board members, comprising three public interest directors – Ashima Goyal, chairperson; D.K. Mehrota, former chairman, LIC; Dilip Gopal Patwardhan, former chief executive, Foreign Exchange Dealers Association of India; besides Udai Kumar.

Chakraborty: legacy issues are behind us

Looking ahead

Goyal, who has been associated with the exchange virtually since inception, is also optimistic about a turnaround. "There are many initiatives the team has been working on in terms of new products and partnerships, identifying comparative advantages, creating synergies, as well as participating in the long-awaited Indian market and growth revival, of which there are some signs." Chakraborty, 45, also with over two decades of experience, the last being at Motilal Oswal, and one of the key persons to have strategised the new plan, is banking on the introduction of products and process innovation to revive the exchange.

MCX-SX, only the third pan-India stock exchange, has had a chequered history. After having commissioned its currency operations in 2008, the exchange faced competition from NSE, the biggest exchange by far (*see* Business India, *dated 16 October 2011*). MCX-SX, which at one time had taken a near leadership position (by turnover in currency trading), had to face competition from the Zero pricing policy adopted by the NSE. The Competition Commission had indicted NSE of abuse of its dominant position, which went beyond promotional and penetrative pricing (*see* Business India, *dated 12 June 2011*). The Competition Commission imposed a penalty on NSE, asking it to pay ₹55 crore and allowed MCX-SX to make a claim for damages suffered. The exchange finally filed a claim of ₹589 crore with the Competition Appellete Tribunal (Compat). This case is yet to come up for hearing in the Supreme Court where the NSE has filed an appeal.



There were also problems faced by the promoters, Jignesh Shah and his team, at Financial Technologies and MCX, who have been mired in the commodity scam of MCX. After the crisis, the promoters had to sell their shares in MCX as also their stake in MCX-SX. Currently, MCX holds 13.82 per cent in the equity of MCX-SX, which was renamed the Metropolitan Stock Exchange of India in March 2015. MCX is now also a professionally run exchange with no notified promoters.

MSEI, post the divestment by the promoters, is also a professionally run exchange, with no notified promoters. MCX is the largest shareholder, with the balance held by banks and institutions, corporate and individuals. SBI, Union Bank, IFCI, Bank of Baroda, Allahabad Bank and PNB are amongst the leading banks and institutions collectively holding 27.2 per cent share. Individuals include marquee investors like Radhakishan Damani, Rakesh Jhunjhunwala, Nemish Shah, Viral Parikh, Kalpraj Dharamshi, and a few others, who collectively hold 35.44 per cent. IL&FS, Edelweiss, Trust Capital and MCX hold 32.70 per cent shares (*see table*: The shareholding pattern). The well-diversified shareholding ensures that no shareholder is allowed to influence the working with the reputed institutions ensuring a high level of governance.

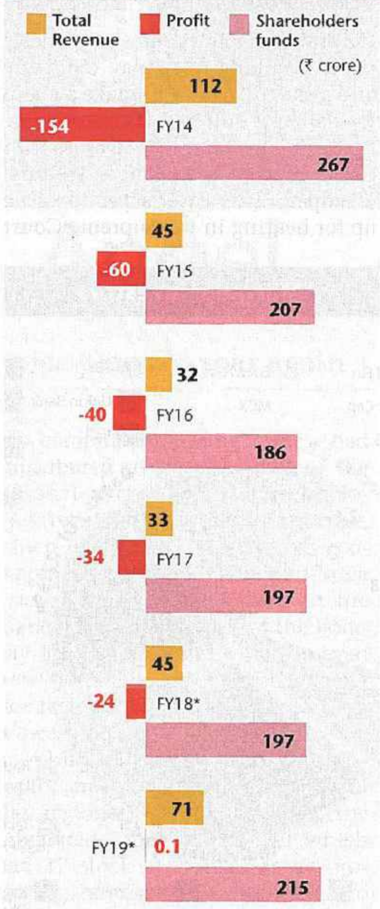
"The legacy issues are behind us and a break from the past does not mean just a change in management," says Chakraborty, who prefers not to talk about the payment of penalty by NSE and the claims made, but wishes to look forward.

Attracting investors

In a bid to differentiate itself from other exchanges, the management is focussing on following a blue ocean strategy, which essentially means getting in uncluttered space and not taking the competition head-on in the areas of their strength. Instead it recently got about 140 companies, earlier listed on the regional stock exchanges to list on its exchange, at a considerably reduced listing fee. There are some 7,000 listed companies on the regional stock exchanges and many of them are unable to pay the high listing fees on BSE and NSE. MSEI aims to get a chunk of these companies. Of the total 162 listed companies on the exchange in 2015-16, as many as 125 were listed only on MSEI. Since listing fees form a significant portion of the revenues of any exchange, MSEI aims to get at least ₹10 crore through this avenue. Besides listing fees, the clearing and settlement through MSEI Clearing Corporation would also mean an increased income for its subsidiary. Currently, about 1,400 companies are available for trading. These are essentially companies where trading is permitted by the exchange even without them being listed. The NSE had initially adopted this strategy by permitting trade in securities even though they were not listed. Trading volumes started picking up once trading in Reliance Industries was allowed on the NSE.

Secondly, instead of taking the NSE and BSE head on in equity trading and derivatives, it is looking at other areas. In a meeting held on 30 March, earlier this year, the management accepted the suggestion of the advisory board to organise an informal meeting with brokers every Friday, establish a connect with FPIs and activate a debt trading platform. The latter has of course been a favoured segment ever since the M.J. Pherwani-headed committee on capital markets, had recommended the setting up of a debt platform. However, neither BSE nor NSE has really been able to popularise debt trading in any meaningful way, despite debt trading being a much bigger market globally. Even in India, fresh corporate bonds and government issuances are estimated at ₹6 lakh crore each, annually. This, along with the outstanding bonds and G-Sec bonds, amounts to ₹107 lakh crore. Even if 1 per cent of this is traded it means a total market of ₹1 lakh crore, which excludes municipal bonds and bonds issued by quasi-state and government institutions.

Road map to profitability



* Estimates

MSEI has about 285 corporate bonds available for trading. MSEI could also be a platform for debt issuances. The BSE, in its retransformation, has set up the OFS platform where capital could be raised by companies through offer for sale, which is normally open for a few days. The BSE is now the preferred place for equity on its OFS platform. "Markets will grow beyond equities, as investors start looking at other asset classes," says Udai Kumar, who is quite enthusiastic about growing the debt market. Standardisation of products to reach out to retail investors is also on the cards. "MSEI aims to be the flag bearer in this segment."

MSEI already has an IRF, interest-rate-futures, trading platform. The average daily trading in this segment has picked up from ₹52 crore in 2014-15 to ₹94 crore in 2015-16. The launch of other unique products in the debt segment is awaiting approval from the regulators.

Phase I of the transformation plan was launched in 2016-17. And its focus has been on reclaiming the market share in currency derivatives and IRF and the launch of block deals and strategic exchange traded funds indices across equity, commodity and debt. To popularise debt, it also plans to introduce contracts in IRF of different tenures.

However, the most innovative idea mooted at the meeting on March 30, 2017 was the creation of a platform for trading of security receipts of distressed assets. With distressed assets especially in the banking sector, many of which are being taken over by asset reconstruction companies, the idea of nursing an asset and selling it to a third party could take off – provided, of course, the underlying assets of the security receipt are valued in a fair and transparent manner and correctly stated. After the harrowing experience of the security scam of 1990, where bank receipts were freely traded, without many having underlying securities and the more recent commodity scam of NSEIL, the regulators would be a little wary of giving permission for such trade of 'distressed asset security receipts'. If, however, MSEI does get permission, the market for these receipts could be huge and run in to several thousands of crores of rupees, with property-backed asset receipts being one of the most favoured ones. It could also help bring about some transparency in the otherwise opaque deals in the distressed property markets.

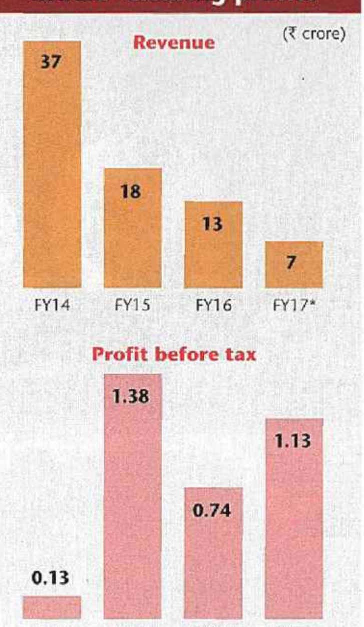
In the equity trading section, the exchange is also looking at ETFs and block trading. In 2015, Star Networks offloaded its entire 25.9 per cent equity stake in Balaji Telefilms on MSEI in a block trade at an average price of ₹63.60 to a host of buyers including promoters Ekta Kapoor and Shobha Kapoor. With markets cruising at an all time high, many such deals could take place with heightened M&A activity with shares being used as a currency. MSEI hopes to get a large chunk of this business from the BSE and NSE. However there are quite a few issues which require to be sorted out as objections have been raised on delisting/divestment through MSEI. And convincing companies to come to MSEI may be a mammoth task.

New chapter

Regaining the market share it ceded in currency derivatives for which the exchange got its licence is, of course, high on MSEI's agenda. In its initial years, it had enjoyed a high market share in currency derivatives trading, which stood at 37.8 per cent in 2012-13 and 34.5 per cent in 2013-14. After the problems of zero pricing and subsequently the problems of its erstwhile promoter, the turnover in 2015-16 had dwindled to less than 5 per cent; now, it is expected to be about 10 per cent in 2016-17. However, till date there has been no profit accruing from this division. The management plans to introduce new products in the derivative segment, to boost turnover and also induce banks and corporates to participate in these products.

The transformation plan has been fine-tuned and, despite many of the

MCCIL- Clearing profits



* Nine months

products still kept under wraps to await the approval of SEBI and RBI, MSEI has plans to get into various other segments, including some popular commodities. Phase II which is planned to be launched in 2018-19 aims to focus on debt and SME listing, besides listing of government bonds trading of shares of SMEs, start-ups and the launch of SME Index. The rationale is that even if 15 per cent of the estimated 30,000 start-ups are viable, there will be about 4,500 of them looking at listing, fetching MSEI listing fees, transaction charges and income for its clearing corporation. BSE is following a different policy for start-ups, its main inducement being lower hassles in the initial stage and high hopes of getting listed on the main exchange, once the start-up grows to sufficient stature – which is a policy similar to what has been followed by LSE with AIMS being the arm for getting companies listed. Phase III included launch of structured products, equity index linked products and credit derivatives linked bonds. Till date however BSE SME Exchange is by far the most successful in getting companies to list.

While the planning has been done in a methodical manner, execution will be the key. Besides other exchanges are also looking at beefing up debt, IRF and commodities segments. And success will lie in matching simplicity with innovativeness. "Technology and product differentiation will matter," says Udai Kumar. What is also important is the reining in of costs to be commensurate with the volumes traded on the exchange. And that is the biggest challenge according to an astute corporate watcher.

While the exchange has still to break even, its net worth, which is mandated to be a minimum of ₹100 crore, and the funds from rights issues has ensured that it is well above this level. PAT from its subsidiary, MSEI's Clearing Corporation was ₹74 lakh in 2015-16, compared to ₹1.38 crore, following reduced business from its erstwhile promoter group companies, like Financial Technologies group. However, a tight rein on costs and other measures enabled MSEI to contain the loss by a third in 2015-16 to ₹40 crore on a consolidated basis. The total accumulated loss is ₹380 crore.

However, with its marquee investors taking a long-term bet on the exchange and willing to pour in funds, resource-constraint may not be a big issue. The promise of getting a bonanza by way of damages suffered from NSE, as may be deemed fit by the Supreme Court, is also one of the factors which has to be considered. Even if there is a compromise thrashed out between NSE and MSEI, the damages will be more than adequate to write off all the accumulated losses of the exchange and make it a profitable one. However, the challenge will be to get liquidity back on the exchange and ensure that transformation plans gets executed and investors again start looking at MSEI as an alternative exchange. If the market continues to go the way it has been going over the next few years, MSEI stands a reasonable chance to transform itself and start writing a new chapter in its chequered history.

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