

GROWTH AND PERFORMANCE OF PRIMARY DEALERS IN INDIA DURING POST LIBERALISATION PERIOD

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ABSTRACT

Primary dealer is a dealer in government debt with whom the Central Bank transacts business. A primary dealer is a bank or securities broker-dealer that may trade directly with the Central Bank. Such firms are required to make bids or offers when the Central Bank conducts open market operations, provide information to the Central Bank's open market trading desk and to participate actively in government's securities transactions. Primary dealer is a formal designation of a firm as a market maker of government securities. Primary Dealers can also be referred to as Merchant Bankers to Government of India as only they are allowed to underwrite primary issues of government securities other than RBI who have since shed this role. Primary dealer systems are present in many countries including Canada, France, Italy, Spain, United Kingdom, United States and India. The system of Primary Dealers (PDs) in the Indian Government Securities Market was introduced by Reserve Bank of India in 1995 to put in place an improved, efficient secondary market trading system. This was to encourage holding of Government Securities on large scale and make the market more vibrant and liquid. In 2006-07, RBI gave Banks the option to undertake Primary Dealership business departmentally. The primary dealers have been playing a very significant role in strengthening the market infrastructure of Government Securities and helping the RBI in its monetary policy decisions. The present research study makes an attempt to highlight the growth and performance of primary dealers since post liberalization period. On the basis of time series analysis of all primary dealers of India, the study concludes that primary dealers are providing yeoman contributions in strengthening the market infrastructure of Government Securities and put in place an improved, efficient secondary market trading system.

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INTRODUCTION

Primary dealer is a dealer in government debt with whom the Central Bank transacts business. A primary dealer is a bank or securities broker-dealer that may trade directly with the Central Bank. Such firms are required to make bids or offers when the Central Bank conducts open market operations, provide information to the Central Bank's open market trading desk and to participate actively in government's securities transactions. Primary dealer is a formal designation of a firm as a market maker of government securities. Primary Dealers can also be referred to as Merchant Bankers to Government of India as only they are allowed to underwrite primary issues of government securities other than RBI who have since shed this role. Primary dealer systems are present in many countries including Canada, France, Italy, Spain, United Kingdom, United States and India. The system of Primary Dealers (PDs) in the Indian Government Securities Market was introduced by Reserve Bank of India in 1995 to put in place an improved, efficient secondary market trading system. This was to encourage holding of Government Securities on large scale and make the market more vibrant and liquid. In 2006-07, RBI gave Banks the option to undertake Primary Dealership business departmentally. The primary dealers have been playing a very significant role in strengthening the market infrastructure of Government Securities and helping the RBI in its monetary policy decisions.

OBJECTIVES OF PRIMARY DEALERS

Primary dealers are expected to play an active role in the government securities market, both in its primary and secondary market segments. The system of Primary Dealers in government securities market was introduced with the objectives to:

- i. strengthen the infrastructure in the government securities market in order to make it
- ii. vibrant, liquid and broad based
- iii. commit participation as Principals in Government of India issues through bidding in auctions
- iv. provide underwriting services
- v. offer firm buy - sell / bid ask quotes for T-Bills & dated securities
- vi. improve Secondary Market trading system
- vii. Make PDs an effective conduit for conducting open market operations.

TYPES OF PRIMARY DEALERS

Primary dealers can be classified as:

- i) Bank Primary Dealers and
- ii) Stand Alone Primary Dealers

Bank PDs are those which take up primary dealer business departmentally as part of the bank itself. On the other hand, Stand Alone Primary Dealers are NBFCs that exclusively take up primary dealer business

At present there are 20 primary dealers doing business of primary dealership as listed below:

Stand Alone Primary Dealers	Bank Primary Dealers
<ol style="list-style-type: none"> 1. Deutsche Securities (India) Pvt. Ltd. 2. ICICI Securities Primary Dealership Limited 3. Morgan Stanley India Primary Dealer Pvt. Ltd. 4. Nomura Fixed Income Securities Pvt. Ltd. 5. PNB Gilts Ltd. 6. SBI DFHI Ltd 7. STCI Primary Dealer Limited 8. Goldman Sachs (India) Capital Markets Pvt. Ltd. 	<ol style="list-style-type: none"> 1. The Royal Bank of Scotland N.V. 2. Bank of America 3. Bank of Baroda 4. Canara Bank 5. Citibank N.A 6. Corporation Bank 7. HDFC Bank Ltd 8. Hongkong and Shanghai Banking Corporation Ltd.(HSBC) 9. J P Morgan Chase Bank N.A, Mumbai Branch 10. Kotak Mahindra Bank Ltd. 11. Standard Chartered Bank 12. Axis Bank Ltd.

OBJECTIVES OF THE STUDY

The present research study makes an attempt to highlight the growth and performance of primary dealers since post liberalization period. The following have been the specific objectives of the study:

- (a) To study the growth of primary dealers since liberalisation.

(b) To study the performance of primary dealers in the Government Securities Market.

DATABASE & METHODOLOGY

The requisite data for achieving the objectives of the study has been compiled from the reports of RBI on Trends and Progress of Banking in India pertaining to the periods from 2006-07 to 2010-11.

DATA ANALYSIS

The performance of primary dealers has been analysed on the basis of the following key parameters:

- a) Performance of Primary Dealers in the Primary Market
- b) Performance of Primary Dealers in the Secondary Market
- c) Sources and Applications of Funds of Primary Dealers
- d) Financial Performance of Primary Dealers
- e) Financial Indicators of Primary Dealers
- f) Select Indicators of Primary Dealers

RESULTS & DISCUSSION

A) PERFORMANCE OF PRIMARY DEALERS IN THE PRIMARY MARKET

Primary dealers are expected to play an active role in the government's primary securities market. PDs are required to support auctions for issue of Government dated securities and Treasury Bills as per the minimum norms for underwriting commitment, bidding commitment and success ratio as prescribed by RBI from time to time. A perusal of Table 1 shows that PDs role in primary market shows a significant improvement since 2006-07.

The success ratio, i.e., the total amount of bids of the PDs accepted to the total commitment of the PDs though declined sharply from 100.42 per cent in 2007-08 to 59.1 per cent yet it has shown an improvement in 2010-11 and has increased to 62 per cent from 56 per cent during 2009-10. PDs are required to achieve a minimum success ratio of 40 per cent for T-Bills and CMBs put together on a half-yearly basis. All the PDs had achieved the stipulated minimum success ratio of 40 per cent during 2006-07 to 2010-11.

Table 1: PERFORMANCE OF THE PDS IN THE PRIMARY MARKET

(As on March 31)

(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Treasury Bills					
Bidding Commitment	1,02,675	1,04,385	2,84,985	4,17,060	3,66,320
Actual Bids Submitted	2,84,686	3,18,201	5,09,794	7,54,041	6,87,416
Bid to Cover Ratio	2.77	3.04	1.8	2.0	2.3
Bids Accepted	96,952	1,04,819	1,72,474	2,33,648	2,27,104
Success Ratio (in per cent)	94.43	100.42	59.1	56.0	62.0
Central Govt. Securities					
Notified Amount	1,46,000	1,56,000	2,61,000	4,18,000	4,37,000
Actual Bids submitted	2,02,462	2,54,253	3,49,393	5,35,722	6,23,939
Bid to Cover Ratio	1.39	1.63	1.34	1.3	1.4
Bids Accepted	64,727	72,122	1,11,094	1,75,609	2,16,535
Share of PDs (in per cent)	44.33	46.23	42.6	42.0	49.6

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

B) PERFORMANCE OF PRIMARY DEALERS IN THE SECONDARY MARKET

An analysis of Table 2 regarding performance of PDs in the secondary market shows that PDs' share of turnover (both outright and repo) in the secondary market has been declining during 2007-08 to 2009-10. However in 2010-11 it showed a marked improvement and has increased to 16 per cent from 8 per cent in 2009-10 on total basis. The decline in share of turnover in the secondary market during 2007-08 to 2009-10 seems to be due their emphasis more on primary market in comparison to secondary market.

Table 2: PERFORMANCE OF THE PDS IN THE SECONDARY MARKET

(As on March 31)
(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Outright					
PDs' Turnover	N.A.	6,37,768	7,96,187	9,02,093	10,89,956
Market Turnover	N.A.	32,68,551	42,55,352	56,84,838	57,41,904
Share of PDs (per cent)	N.A.	19.5	18.7	15.9	19.0
Repo					
PDs' Turnover	N.A.	24,00,106	18,21,096	17,00,382	11,45,970
Market Turnover	N.A.	1,55,75,515	1,62,34,732	2,41,83,229	81,98,568
Share of PDs (per cent)	N.A.	15.4	11.2	7.0	14.0
Total					
PDs' Turnover	N.A.	30,37,873	26,17,283	26,02,475	22,35,926
Market Turnover	N.A.	1,88,44,065	2,04,90,084	2,98,68,067	1,39,40,472
Share of PDs (per cent)	N.A.	16.1	12.8	8.7	16.0

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

C) SOURCES AND APPLICATIONS OF FUNDS OF PRIMARY DEALERS

An analysis of Sources and Application of Funds of Primary Dealers (Table 3) led to conclusion that capital of PDs has declined significantly to 1508 crore in 2007-08 from 2088 crore in 2006-07. This decline has been attributed mainly due to capital restructuring by PDs during 2007-08. During the year 2010-11, IDBI Gilts Ltd. and Nomura Fixed Income Securities Ltd. had infused fresh capital. However, on account of partial buy-back of its capital by SBI DFHI Ltd., the capital as also reserves and surplus of the PDs put together declined marginally.

The unsecured loans of the PDs declined from 4320 crore in 2009-10 to 3271 crore in 2010-11t. However, secured loans has increased significantly to 6352 crore in 2010-11 from 2522 crore in 2009-10. A further analysis of application of funds shows that fixed assets has shown a declining trend during 2006-07 to 2009-10, however it has shown a significant increase by 24 crore in 2010-11. Further, investments of PDs has also been showing a declining trend from 2006-07 to 2009-10. However it has shown an increase by 2537 crore as compared to previous year mainly due to increase in investment in government securities and corporate bonds.

Table 3: SOURCES AND APPLICATION OF FUNDS OF STANDALONE PDS

(As on March 31)

(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Sources of Funds	13,557	10,882	10,307	10,308	13,030
1 Capital	2,088	1,508	1,121	1,541	1,521
2 Reserves and Surplus	3,102	1,944	2,213	1,925	1,886
3 Loans (a+b)	8,367	7,430	6,973	6,842	9,622
a) Secured	3,910	4,580	2,945	2,522	6,352
b) Unsecured	4,457	2,850	4,028	4,320	3,271
Application of Funds	13,557	10,882	10,307	10,308	13,030
1 Fixed Assets	72	14	13	14	38
2 Investments (a+b+c)	9,248	8,291	7,891	7,280	9,817
a) Government Securities	7,412	7,584	7,305	6,258	8,648
b) Commercial Papers	1,241	86	88	142	10
c) Corporate Bonds	595	621	498	880	1,160
3 Loans and Advances	1,135	429	959	741	429
4 Non-current Assets	-	-	0	0	0

5 Equity, Mutual Funds, etc.	928	150	22	68	25
6 Others*	2,174	2,148	1,422	2,205	2,721

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

D) FINANCIAL PERFORMANCE OF PRIMARY DEALERS

A perusal of financial performance of primary dealers as depicted in Table 4 shows that its gross income has declined significantly in 2007-08 by 643 crore (33%) as compared to 2006-07. This decline has been mainly attributed to restructuring of business by PDs as a result other incomes has declined sharply by 841 crore (859%) in 2007-08 in comparison to 2006-07. However, a corresponding sharp decline in the expenses by 539 crore (410%) and increase in trading profits by 272 crore has restricted the decline in net profit during 2007-08. Further in spite of improvement in the trading income, net profit of the PDs declined by 49 crore (21.5%) in 2010-11 in comparison to 2009-10 mainly on account of increase in interest expenses and decline in other income. Hardening of Government Securities returns during the year impacted the treasury profits of standalone PDs

Table 4: FINANCIAL PERFORMANCE OF STANDALONE PRIMARY DEALERS

(As on March 31)

(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
A. Income (i + ii + iii)	1,950	1,307	1,825	804	1,079
i) Interest and discount	986	914	878	690	970
ii) Trading Profit	-17	255	843	-30	58
iii) Other income	979	138	104	144	51
B. Expenses (i + ii)	1,314	775	692	452	811
i) Interest	668	595	546	302	653
ii) Administrative Costs	645	180	146	150	158

Profit Before Tax	636	531	1,133	343	272
Profit After Tax	444	373	749	227	178

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

E) FINANCIAL INDICATORS OF PRIMARY DEALERS

Financial indicators of standalone primary dealers as presented in Table 5 have shown a grim picture of state of affair of PDs since 2006-07. With the exception of the year 2008-09 net profit of PDs has been showing a declining trend. As a result of declining profit, return on average assets also showing a declining trend since 2006-07 except in the abnormal year 2008-09. Although, average assets of primary dealers showed a smart recovery in 2010-11 as compared to 2009-10

Yet due to decline in net profit, it has been able to achieve a meager return of 1.1 per cent only in 2010-11.

Table 5: Financial indicators of Standalone Primary Dealers

(As on March 31)

(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
i) Net Profit	444	373	749	227	178
ii) Average Assets	14984	15,039	11,348	12,815	16,697
iii) Return on Average Assets (in per cent)	3.0	2.5	6.6	1.8	1.1

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

F) SELECT INDICATORS OF PRIMARY DEALERS

A perusal of the Table 6 shows that stand-alone primary dealers continued to adequately capitalized since 2006-07. The capital to risk weighted-assets ratio (CRAR) of individual standalone PDs remained above the prescribed minimum of 15 per cent during the years 2006-07

to 2010- 2011. The CRAR of the stand-alone PDs as a group showed an increasing trend and it has grown to 46.2 per cent in 2010-11 from 33 per cent in 2006-07.

Table 6: SELECT INDICATORS OF PRIMARY DEALERS

(As on March 31)

(Amount in Crore)

	2006-07	2007-08	2008-09	2009-10	2010-11
Total Assets(Net of Current Assets and Current Liabilities)	13557	10882	10,307	10,308	13,030
of which: Government securities	7412	7584	7,305	6,258	8,648
Government securities as percentage of total assets	55	70	70.9	61	66
Liquidity Support Limit	3000	3000	3000	3,000	3,000
CRAR (in per cent)	33	38	34.8	43.5	46.2
Total Capital Funds	4026	3611	3,464	3,610	

Source: Compiled from RBI Report on Trends and Progress of Banking In India, 2006-07,2007-08,2008-09,2009-10,2010-11 (www.rbi.org.in)

CONCLUSION

From the preceding analysis it can be observed that despite of declining profitability position the primary dealers have been playing a very significant role in strengthening the primary as well as secondary market infrastructure of Government Securities and helping the RBI in its monetary policy decisions. On the basis of time series analysis of all primary dealers of India, the study concludes that primary dealers are providing yeoman contributions in strengthening the market infrastructure of Government Securities and put in place an improved, efficient secondary market trading system.

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