

Abstract

There exists a peculiar feature in India's financial markets today called badla. Badla is a facility for borrowing funds or shares, using which speculators obtain leveraged positions on the market. This facility is provided only in Group A stocks on the Bombay Stock Exchange (BSE). Badla has been the centre of controversy since long time. We need to learn about how it matters for the market. In this study, I measure the impact of classification of stocks as Bombay Stock Exchange (BSE) group A stocks on their performance. In November 1997, Securities and Exchange Board of India (SEBI) relaxed the rules of Badla trading. This was followed by BSE's directive to add fifty more stocks to group A. The BSE moved fifty stocks from Group B to Group A with effect from February 23, 1998. With this the BSE now has hundred and fifty stocks in group A in which investors can trade on carry-forward basis.

This thesis is the study of a natural experiment which allows to measure the effect of changes in the market microstructure in the sense of changes in the classification of stocks as Group A stocks on BSE. The impact of this new classification is measured in terms of liquidity, volatility and market efficiency.

From this study, it has been observed that the event (moving of 50 stocks from Group B to Group A) has an impact on liquidity of newly added stocks i.e., there is a significant change in liquidity of these stocks. There was no significant effect of the event on the volatility of the newly added stocks. It is observed that, even though there is an overall improvement in market efficiency with respect to the experimental and control samples, in terms of reduction in number of rejections of the null hypothesis, there is no evidence on improvement with respect to experimental sample compared to the control sample. The null hypothesis here is that the auto correlations are statistically close to zero. The cumulative returns of the hedged portfolio of experimental sample against the control sample shows no significant effect of the event around the event occurrence. So, there is no evidence on the existence of liquidity premium in the market.