Indian Capital Market: A Review

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Abstract

The present review article is an attempt by the researchers to make a descriptive as well as analytical study of work done in the field of Indian capital market. This study will be focusing on various loopholes in the Indian Financial System. As capital market is a wider concept, lots of note worthy contribution have been made in this area. In this write up emphasis are given to bring to light all the hard work done by various researches and to uncover the gap for future research. Apart from that the researchers have also highlighted some of the important reforms in Indian Capital Market since 1991 onwards. While studying a range of literature available from various resources, the researchers havearrived that there isgenerally a constructive assessment of the economic reforms on Indian Capital Market, but also points out some areas of concern: the lack of a fixed term appointment for the regulators; the persistence of non-competitive conditions in the market; and the excessive entry of new scripts into the market, Although in recent days, some steps have been taken to address this problem as well.

Keywords:Capital market, Indian capital market, shares, capital market reforms.

Structure of financial system in India

Broadly speaking, the Indian financial system can be divided into two constituents i.e. Money Market and Capital Market. Capital Market can be further divided into two constituents (i) The Financial Institutions and (ii) Securities Market. The Securities Market is divided into (i) Gilt-Edged Market [1]and (ii) The Corporate Securities Market which consists of new issue market and stock exchange.

The Indian Money Market

Money Market is a mechanism whereby on the one hand borrowers manage to obtain short-term loanablefunds and on the other hand, lenders succeed in getting credit worthy borrowers for their money. In Money Market, Commercial banks are the most important lenders. These banks are not

1 The market of govt. securities

merely lenders of money, they also create credit. The role of central bank is important as it existed in India since pre-independence period, was an undeveloped one than what it is today. Now the Indian Money Market is perhaps one of the most organised Money Market, in spite of all its limitations and defects. The reserve Bank of India is the apex organization in the Money Market. Since it is the leader and controller of Money Market, it has great responsibility in respect of smooth functioning of the Financial Market.

The capital market is the market for securities, where companies and governments can raise long term funds. Selling stock and selling bonds are two ways to generate capital and long term funds. It provides a new avenue to corporate and government to raise funds for long term. Capital markets expand the investment options available in the country, which attracts portfolio investments from abroad. Domestic savings are also facilitated by the availability of additional investment options. This enables to bridge the gap between investment and savings and paves the way for economic development. Capital market in any country provides the corporate and government to raise long term finance at a low cost as compared to other modes of raising finance Therefore capital market is important, more so for India as it embarks on the path of becoming a developed country and provides an avenue for investors to park their surplus funds. Capital market provides the investors both domestic as well as foreign, various instruments to invest their surplus funds. Not only it provides an avenue to park surplus funds but it also helps the investors to reap decent rewards on their investment. This realization has resulted in increased investments in capital market both from domestic as well as foreign investors in Indian capital market.

The capital market plays a very important role in promoting economic growth through themobilization of long-term savings and the savings get invested in the economy for productive purpose. Thecapital market in India is a well-integrated structure and its components include stock exchanges,developed banks investment trusts, insurance corporations and provident fund organization. It caters to thevaried needs for capital of agriculture, industrial and trading sectors of the economy. There are twoimportant operations carried on in these markets. The raising the new capital and Trading in the securitiesalready issued by the companies. The capital market deals with capital. Capital Market is generallyunderstood as a market for long term funds and investments in long term instruments available in thismarket. Capital markets mean the market for all the financial instruments, short term and long term as socommercial industrial and government paper.

Due to the swiftness of economic reforms followed in India, the role of Capital Market has grown during last decade or so. Corporate both in the private sector as well as in the public sector raise thousands ofcrores of rupees in these markets. The governments, through Reserve Bank of India, as well as financialinstitutes also raise a lot of money from these markets. The capital market serves a very useful purpose bypooling the savings. The capital markets encourage capital formation in the country. The capital marketsmobilize savings of the households and of the industrial concerns. Such savings are then invested forproductive purposes. Capital markets also facilitate the growth of the industrial sector, as well as the othersectors of the economy. The capital markets provide funds for the projects in backward areas. Thus, Capitalmarkets generate employment in the country.

Reforms in Capital Market of India

The majorreforms undertaken in capital market of India includes:-

1. Establishment of SEBI

The Securities and Exchange Board of India (SEBI) was setup in 1988 and was legalized in 1992. The primary function of SEBI is to regulate the activities of the merchant banks, to control theoperations of mutual funds, to work as a promoter of the stock exchange activities and to act as aregulatory authority of new issue activities of companies. The SEBI was set up with thefundamental objective, "to protect the interest of investors in securities market and for mattersconnected therewith or incidental thereto."

2. Establishment of Creditors Rating Agencies

Three creditors rating agencies viz The Credit Rating Information Services of India Limited(CRISIL - 1988), the Investment Information and Credit Rating Agency of India Limited (ICRA-1991) and Credit Analysis and Research Limited (CARE) were set up in order to assess thefinancial health of different financial institutions and agencies related to the stock marketactivities. It is a guide for the investors also in evaluating the risk of their investments.

3. Increasing of Merchant Banking Activities

Many Indian and foreigncommercial banks have set up their merchant banking divisions in the lastfew years. These divisions provide financial services such as underwriting facilities,issue organizing, consultancy services, etc. It has proved as a helping hand to factors related to thecapital market.

4. Candid Performance of Indian Economy

In the last few years, Indian economy is growing at a good speed. It has attracted a huge inflow ofForeign Institutional Investments (FII). The massive entry of FIIs in the Indian capital market hasgiven good appreciation for the Indian investors in recent times. Similarly many new companiesare emerging on the horizon of the Indian capital market to raise capital for their expansions.

5. Rising Electronic Transactions

Due to technological development in the last few years, the physical transaction with more paperwork is reduced. Now paperless transactions are increasing at a rapid rate. It saves money, timeand energy of investors. Thus it has made investing safer and hassle free encouraging more peopleto join the capital market.

6. Growing Mutual Fund Industry

The growing of mutual funds in India has certainly helped the capital market to grow. Publicsector banks, foreign banks, financial institutions and joint mutual funds between the Indian and foreign firms have launched many new funds. A big diversification in terms of schemes, maturity,etc. has taken place in mutual funds in India. It has given a wide choice for the common investorsto enter the capital market.

7. Growing Stock Exchanges

The numbers of various Stock Exchanges in India are increasing. Initially the **BSE** was the main Exchange, but now after the setting up of the NSE and the OTCEI, stock exchanges have spreadacross the country. Recently a new Inter-connected Stock Exchange of India has joined theexisting stock exchanges.

8. Investor's Protection

Under the purview of the SEBI the Central Government of India has set up the InvestorsEducation and Protection Fund (IEPF) in 2001. It works in educating and guiding investors. Ittries to protect the interest of the small investors from frauds and malpractices in the capitalmarket.

9. Growth of Derivative Transactions

Since June 2000, the NSE has introduced the derivatives trading in the equities. In November2001 it also introduced the future and options transactions. These innovative products have givenvariety for the investment leading to the expansion of the capital market.

10. Insurance Sector Reforms

Indian insurance sector has also witnessed massive reforms in last few years. The InsuranceRegulatory and Development Authority (IRDA) was set up in 2000. It paved the entry of theprivate insurance firms in India. As many insurance companies invest their money in the capitalmarket, it has expanded.

11. Commodity Trading

Along with the trading of ordinary securities, the trading in commodities is also recentlyencouraged. The Multi Commodity Exchange (MCX) is set up. The volume of such transactions isgrowing at a splendid rate.Apart from these reforms the setting up of Clearing Corporation of India Limited (CCIL), VentureFunds, etc., have resulted into the tremendous growth of Indian capital market. SEBI vide its press release PR No.59/2010 dated March 6, 2010 has announced the decisions ofthe board meeting of SEBI held on the same day.

Objectives of the Study

- **To gain insight into the Indian capital market.**
- **To analyse the effect of economic reforms on Indian Capital Market.**
- **To provide suggestive measures for future prospectus.**

Review of Literature

Subir Gokarn (1996) in his research paper **"Indian Capital Market Reforms, 1992-96 An Assessment"** has used a conceptual framework that draws on the theory of regulation on the one hand and the new political economy on the other to make an assessment of the wide-ranging reforms that have been initiated in the Indian stock market over the past four years. Based on the framework the various reforms are classified into categories reflecting their regulatory effectiveness and/or their impact on sources of market failure. The researcher arrives at a generally positive assessment of the reforms, but points out three areas of concern: the lack of a fixed term appointment for the regulators; the persistence of non-competitive conditions in the market; and the excessive entry of new scripts into the market, Although in recent days, some steps have been taken to address this problem as well.

Anand Pandey (2003) in his thesis entitled **"Efficiency of Indian Stock Market"** made an analysis of three popular stock indices to test the efficiency level and random walk nature of Indian equity market. The study presented the evidence for inefficient form of Indian market. Autocorrelation analysis and runs test concluded that the series of stock indices in India are biased random time series.

Selvam M (2008) inhis research paper **"Efficiency of Indian Capital Market to react adequately to the announcement of quarterly earnings: A study in Capital goods Industry"** has stated that an efficient and integrated capital market, is an important infrastructure that facilitates capital formation. The efficiency with which the capital formation is carried out depends on the efficiency of the capital markets and financial institutions. A capital market is said to be efficient with respect to an information item if the prices of securities fully impound the returns implications of that item. The present study has empirically examined the informational efficiency of Indian capital market with regard to quarterly earnings released by the automobile sector companies in the semi-strong form of EMH. The study found that the Indian Capital market is near efficient in the semi- strong form of EMH, which can be used by the investors to make abnormal returns.

Jumba Shelly (2010) in her report "A project on Capital Market" has ascertainedthatthe performance of the company's or corporate earnings is one of the factors which have direct impact or effect on capital market in a country. Weak corporate earnings indicate that the demand for goods and services in the economy is less due to slow growth in per capita income of people. Because of slow growth in demand there is slow growth in employment which means slow growth in demand in the near future. Thus weak corporate earnings indicate average or not so good prospects for the economy as a whole in the near term. In such a scenario the investors (both domestic as well as foreign) would vary to invest in the capital market and thus there is bear market like situation. The opposite case of it would be robust corporate earnings and its positive impact on the capital market.The researcher has also added thatthe macroeconomic numbers also influence the capital market. It includes Index of Industrial Production (IIP) which is released every month, annual Inflation number indicated by Wholesale Price Index (WPI) which is released every week, Export – Import numbers which are declared every month, Core Industries growth rate (It includes Six Core infrastructure industries – Coal, Crude oil, refining, power, cement and finished steel) which comes out every month etc. This macro –economic indicators indicate the state of the economy and the direction in which the economy is headed and therefore impacts the capital market in India.

Ahuja Juhi (2012) in her research paper entitled ***"*Indian Capital Market: An Overview with Its Growth**" has examined that there has been a paradigm shift in Indian capital market. The application of many reforms & developments in Indian capital market has made the Indian capital market comparable with the international capital markets. Now, the market features a developed regulatory mechanism and a modern market infrastructure with growing market capitalization, market liquidity, and mobilization of resources. The emergence of Private Corporate Debt market is also a good innovation replacing the banking mode of corporate finance. However, the market has witnessed its worst time with the recent global financial crisis that originated from the US sub-prime mortgage market and spread over to the entire world as a contagion. The Capital Market in India delivered a sluggish performance.

Geetha et al (2012) in their research paper titled **"Capital Market in India: A Sectorial Analysis"** had made an attempt to compare and contrast the risk return characteristics of ten major industrial sectors which account for 88.74% of the economy's industrial production. A comparative analysis is done on the annual returns, total risk, systematic risk, abnormal returns and correlation of each sectoral index. It was observed that the sectoral indices exhibited significant difference in their risk return characteristics and they also followed business cycles of recession, recovery and boom in their performance. Indian economy has emerged as one of the most attractive destinations for business and investment opportunities due to huge manpower base, diversified natural resources and strong macro-economic fundamentals. Indian economy in the world market is explained in terms of statistical information provided by the various economic parameters. Such indicators include Gross Domestic Product (GDP), Gross National Product (GNP), Per Capita Income, Whole sale Price Index (WPI), Consumer Price Index (CPI), etc. The economic indicators as mentioned are recently enhanced with a new indicator – the capital market index, which had for years proved to be a measure of the investor sentiment in an economy. It had been one of the leading indicators of economic performance in many countries and India also views it with substantial importance as an indicator of market sentiment. The stock market indexes thus prove to be efficient tools to measure the performance of Indian capital market and hence present an overall idea of the economy as a whole. In this paper an attempt has been made for making an analysis of the performance of major industrial sectors operating in the stock market. While concluding it have been stated the Indian Capital Market is highly diversified with numerous industrial sectors operating within it. The study provides an overview of the risk return characteristics of ten major industrial sectors in the Indian market. Investment decisions are generally made on the basis of performance of a stock and the expectations of the investor – capital gain, regular income, liquidity etc.; in addition there are some other indicators that investors would attach importance are return, risk and volatility.

Kumar Bharath & Sampath Sangu (2012) through their research paper entitled **"Corporate Governance and Capital Markets: A Theoretical Framework"** has outline a conceptual framework of the relationship between relationship between corporate governance and two important determinants of capital market development namely, a firm's access to finance, and its financial performance. The framework assumes that a firm's corporate governance is simultaneously determined by a group of related governance components and other firm characteristics. In this study an attempt is made to know how organisations are fair in corporate governance and capital market. It was explained that firm-level corporate governance quality can enhance both the firm's ability to gain access to finance and its financial performance, which eventually lead to capital market development.

Sandhya.C et al (2012) in their research article titled **"A study on Volatility Index Indian Capital Market: An evaluation of NSE"** has examined and stated that If a stock is more volatile, it is also more risky also known as beta, risk, relative volatility, implied volatility. Volatility is a measure of dispersion around the mean or average return of a security. It has been ascertained that NSE indices had more volatility in the year 2007 and 2009; market was showing bullish trend and the stock market reached the peak points. In the year 2008 market showed the down ward moment due to the American mortgage crises it affected the other markets. In May 2006 due to foreign institutional investment caused for volatility in May, 2006. While investing in the stock market the investor should take into consideration factors like the performance of the market, policy change announcement, increasing and decreasing the interest rates, regulation of the government and encouragement of the priority sectors. All these factors considerably affect the Capital Market and should be taken into account in order to know about the economic condition of the nation.

Another remarkable contribution in this field is through the research paper of **AnsariMohd Shamim(2012)** entitled "**Indian Capital Market Review: Issues, Dimensions and Performance Analysis**" in which the researcher has ascertained that the purpose of an efficient capital market is to mobilize funds from those who have it and route each them to those who can utilize it in the best possible way. The researcher has also analyzed that India's financial market is multi-facet but not balanced. Further it has been stated that the Indian capital market in the recent year has undergone a lot of innovation in term regulation and mode of operation. The researcher while concluding has stated that India needs innovative financial instrument in its domestic capital market. Financial Innovation must aim value addition in existing technologies, risk management practices, credit system, process, and products. As per the analysis of the researcher there is positive correlation between finance and economic growth. Thus, economic development is relatively impossible without quality innovation in financial market. The researcher has also added that the creation of a deep and robust debt capital mechanism is the key to financing infrastructure companies by allowing them to raise long term debt. At last the researcher has concluded with this fact that emerging economies like India have an advantage of learning from the mistakes of others.

Another prominent part comes from **Shaik Abdul Majeeb Pasha (2013)** duringhis research paper **"An Evolutionary Critical approach on Indian Capital Market Developments**". In this paper the researcher has examined various kinds of changes that have taken place in Indian Capital Market before and after globalisation, liberalization and privatization (GLP) era and wants to evaluate critically capital market system as well as Securities and Exchange Board of India (SEBI) role in India. In fact, it is observed that, on almost all the operational and systematic risk management parameters, settlement system, disclosures, accounting standards, the Indian Capital Market is at par with the global standards with little bit loopholes. While concluding it has been briefly noticed that a perception is steadily growing about the Indian Capital Market, as a dynamic market.

Conclusion

The assessment and review of literature about the financial sector reforms in Indiareveals that the reforms have been pursued vigorously and the results of the reformshave brought about improved efficiency and transparency in the financial sector. Thereforms also brought into inter-linkage of financial markets across the globe leading tonew product development and sophisticated risk management tools.The application of many reforms & developments in Indian capital market has made the Indian capital market comparable with the international capital markets. Now, the market features a developed regulatory mechanism and a modern market infrastructure with growing market capitalization, market liquidity, and mobilization of resources. The emergence of Private Corporate Debt market is also a good innovation replacing the banking mode of corporate finance. The researchers have ascertained that the purpose of an efficient capital market is to mobilize funds from those who have it and route each them to those who can utilize it in the best possible way. The researchers has also analyzed that India's financial market is multi-facet but not balanced. Further it has been stated that the Indian capital market in the recent year has undergone a lot of innovation in term regulation and mode of operation. India needs innovative financial instrument in its domestic capital market. Financial Innovation must aim value addition in existing technologies, risk management practices, credit system, process, and products. As per the analysis of the researchers there is positive correlation between finance and economic growth. Thus, economic development is relatively impossible without quality innovation in financial market. The researcher has also added that the creation of a deep and vigorous debt capital mechanism is the key to financing infrastructure companies by allowing them to raise long term debt. At last the researchers have concluded with this fact that emerging economies like India have an advantage of learning from the mistakes of others.

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