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ROLE OF EQUITY: AN INSTRUMENT FOR ECONOMIC DEVELOPMENT

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Abstract: *Equity market has progress in the last decade. It has become tool of economic development. Stock market development and long-run economic growth are closely linked together. Equity Markets serve many different roles that are particularly important in emerging markets. For Countries development not only need a well-functioning banking sector but in addition also need a well-developed Equity market, ,Banks in emerging markets has become supporting factor to equity market development. Improvements in the functioning of a developing equity market results in higher debt-equity ratios, and thus more business for banks. Equity market markets and banks play different but complementary roles. Stock markets exist to help allocate funds to firms and liquidity to investors. Now equity market has become a source of capital and dependence on debt is been reduced. Investors are no longer restricted by national boundaries. Technology has made it easy for investors to invest and trading has become easy, transactions costs has become low, and access to information almost free due to use of internet in equity market This paper discusses the role of equity market in the development of country's economy.*

Key words: *Equity market, Economic development, Stock market*

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INTRODUCTION

Capital market is the centre or arrangement that provides facilities for buying and selling of long-term financial claims. It is the market where transactions are made in long term securities such as stocks and bonds. The participants of this market includes various financial institutions, mutual funds, agents, brokers, dealers and other borrowers and lenders of long term debt and equity capita The primary market or otherwise called as new issue market is one in which long term capital is raised by corporate directly from the public. The secondary market or popularly called as the stock market refers to the market where these long-term financial instruments which are already issued in the primary market are traded. The rapid economic growth in the past one hundred years gave rise to the explosive development of stock markets. At the same time the enhancement of stock markets has played an important role in promoting the growth of the world economy. The modern market economy depends to a greater extent on a soundly operated stock market. Stock market provides liquidity to the financial instruments which are issued in the primary market. Players in the capital include Companies issuing securities and include new companies, existing unlisted companies and the existing listed companies. Intermediaries who assist in the process of transferring savings into investment and they include merchant bankers, underwriters, registrars to issue and share transfer agents, brokers, depositories, collecting agents, advertising agencies, agents, mutual funds etc. Investor consists of institutional investors and the general public.

GROWTH OF EQUITY MARKET

Liberalization was set in motion in the mid-eighties and its pace was accelerated in 1991 when the economy suffered severely from a precariously low foreign exchange reserve, burgeoning imbalance on the external account, declining industrial production, galloping inflation and a rising fiscal deficit. The economic reforms, being an integrated process, included deregulation of industry, liberalization in foreign investment, regime, restructuring and liberalization of trade, exchange rate, and tax policies, partial disinvestments of government holding in public sector companies and financial sector reforms. The reforms in the real sectors such as trade, industry and fiscal policy were initiated first in order to create the necessary macroeconomic stability for launching financial sector reforms, which sought to improve the functioning of banking and financial institutions (FIs) and strengthen money and capital markets including securities market. The securities market reforms specifically included:

- Repeal of the Capital Issues (Control) Act, 1947 through which Government used to expropriate and allocate resources from capital market for favored uses;
- Enactment of the Securities and Exchange Board of India Act, 1992 to provide for the establishment of the Securities and Exchange Board of India (SEBI) to regulate and promote development of securities market;
- Setting up of NSE in 1993, passing of the Depositories Act, 1996 to provide for the maintenance and transfer of ownership of securities in book entry form;
- Amendments to the Securities Contracts (Regulation) Act, 1956 (SCRA) in 1999 to provide for the introduction of futures and option.
- Other measures included free pricing of securities, investor protection measures, use of information technology, dematerialization of securities, improvement in trading practices, evolution of an efficient and transparent regulatory framework, emergence of several innovative financial products and services and specialized FIs etc.

These reforms are aimed at creating efficient and competitive securities market subject to effective regulation by SEBI, which would ensure investor protection.

ROLE OF EQUITY MARKET

When we talk about the stock market the first thing come into our mind is this is an important element of a economy because stock market plays a vital role in the growth of key sectors of the economy and that ultimately affects the economy of the country. Stock market plays the significant role for the **industry** and also for the i**nvestor** who wants to invest in the stock market to gain maximum return on his savings. Whenever any company wants to raise funds and consider other than debt option they float their shares into the market and raise funds from the investors who keen to invest in that company the company list themselves in the stock market and issue their shares through IPO (Initial Public Offering) if the company is already listed in the stock market and want to raise fund by floating their shares they have two options available either they offer their shares to the market and anyone who is interested to invest in that company purchase their shares or they offer the right shares to the existing share holders.

The primary function of any stock market is to play the role of **supporting the growth of the industry and economy of the country** and it is also the measurement tool that gives the idea about the industrial growth as well as the stability of the economy with their performance. The rising index or consistent growth in the index is the sign of growing economy and if the index and stock prices are on the falling side or their fluctuations are on the higher side it gives the impression of un stability in the economy exist in that country.

On the other side we know that the growth of the country is directly related to the economy which consists of various variables like GDP, Foreign Direct Investment, Remittances, Inflation, Interest rate, Money supply, Exchange rate and many others. These variables are the backbone of any economy. The movements in the stock prices are affected by changes in fundamentals of the economy and the expectations about future prospects of these fundamentals. Stock market index is a way of measuring the performance of a market over time. These indices used as a benchmark for the investors or fund managers who compare their return with the market return. Number of studies conducted in USA, UK and Japan to find out the relationship between macroeconomic variables and the fluctuations of stock prices.

A well regulated and properly functioning capital market clearly plays many roles and offers many benefits. Capital markets allow the efficient transfer of funds between borrowers and lenders. Households and investors who are short of funds to take up profitable investment opportunities that yield rates of return higher than the market are able to borrow funds and invest more than they would have done without capital markets. Consequently, all borrowers and lenders are better off than they would have been without capital markets. In the long term, a stock market fosters economic development by promoting efficient resource allocation over time. In addition, market determined stock prices and yields provide a benchmark against which the cost of capital for and returns on investment projects can be judged, even if such projects are not in fact financed through the stock markets. As stock markets are forward looking, they also provide a unique record of the shifts in investors� views about the future prospects of companies as well as the economy. In many respects, therefore, a capital market is a vast information exchange, which efficiently reduces transaction costs (Green, Maggioni and Murinde, 2000).

However, to play the above roles and attain these ideals, a capital market needs to be effectively organized and operated, with a continuous flow of orders around the equilibrium prices bubbles (Green, Maggioni and Murinde, 2000).

There are many benefits to investing in shares:

1. Income return

The income return represents periodic cash flows generated by the investment. Stocks that pay dividends typically distribute them quarterly.. Investors whose primary objective is to generate periodic income from their investments focus on the income return.

2. Price change

Price change is the increase or decrease in price of the asset in relation to the purchase price or the market price in the previous time period. An appreciation in the price of the asset is called a **capital gain** while a price decline is called a **capital loss**. The prices of assets such as stocks, bonds, and real estate fluctuate over time in response to a variety of factors such as economic news, industry conditions, company`s performance, political conditions, as well as speculation. While the investor expects a capital gain, there is no guarantee that the price will always increased in value. Those investors whose primary investment objective is capital appreciation focus on the price change component of return.

3. Voting right

Shareholders have a say in the affairs of the company. One of the ways they express themselves is by voting at the annual and Extra-ordinary general meetings of the company. Shareholders do not necessarily need to be physically present at the site of the company's annual meeting in order to exercise their right to vote. It is common for shareholders to voice their vote by proxy by mailing in their response.

4. Right issues

A rights issue is an invitation to existing shareholders to purchase additional new shares in the company. More specifically, this type of issue gives existing shareholders securities called "rights", which, well, give the shareholders the right to purchase new shares at a discount to the market price on a stated future date.

5. Capitalization of reserves

When reserves are paid out to shareholders in the form of extra shares is called capitalization of reserves. In other way, Capitalization of Reserves is the issue of shares by the company to its existing shareholders by capitalizing its revenue reserves. Share holders receive free shares in proportion to their ownership.. When the company issues free shares by doing capitalization of reserves the company`s stated capital and the total number of shares will be increased.

6. Stock splits

Sometimes, companies split their shares into more shares. A stock split is where a company subdivides its outstanding shares so as to increase the number of shares.. The company does not receive any funds, and hence, there is no change in the value of the firm. The only change is that the company will transfer the value of the new shares from revenue reserves to share capital. However since the firm has more shares now, the price per share will decline to reflect this.

7. Liquidity

Another benefit of investing in shares is that it is a liquid asset. The stocks traded in the market also have greater liquidity than other securities. This means that it can be easily converted into cash by selling the equities with other traders in the market because it is relatively easy to find buyers .Compare this to selling property, where you may have only 1 or 2 interested buyers.

8. Accessibility

Another advantage of investing in stocks is its accessibility. There are many stocks available in the market today. With proper research and analysis of the stocks and the companies that issued them, anybody with sufficient capital can acquire ownership of stocks except some specific stocks.

9. Ease of diversification

Diversification is simply not putting all your eggs in one basket. If you make smaller investment in various different companies, the likelihood that one of your investments fails means that it won't have a great effect on your total investment. If you have all your eggs spread between a numbers of baskets (investments), you are more insulated from any possible downturns. Because you can buy small parcels of shares ($500 is the minimum per parcel), you can get greater diversification though investing in shares. Compare this to say property where a large sum of money is placed in just one investment.

10. Tax benefits

Many of the costs associated with share trading are tax deductible, as you have to pay tax on your gains. Transaction fees, interest paid on margin loans and other costs associated with your investments can be deducted as an expense from your taxable income from the shares you've traded. Tax benefits can also come from franking credits (imputation credits) from shares. As companies have already pay tax on their profits investors receive franking credits on the dividends they receive.

11. Availability of information

Information about a particular companies shares can be from everywhere like news on TV, newspaper and financial websites.

Some of the **other advantages** of investing in the stock market include:

- Superior long term performance - over the long term, stocks have consistently provided better returns than any other type of investment.
- Stocks have consistently stayed ahead of the inflation rate, something that is not always true of bonds and other fixed income investments. For instance, if your money market is yielding 2% a year, but inflation is 3%, you are actually losing money. The returns of the stock market provide investors with a better chance of staying ahead of inflation.
- Owning stocks allows the investor to participate in the growth of the economy. When you buy shares of stock, you actually become part owner of the company, and you therefore are entitled to share in the good fortunes of that company.
- Stocks can be an excellent choice for retirement vehicles, especially for those with a long time to retirement. The longer your time horizon, the more valuable stocks can be. A longtime horizon will help to even out the inevitable ups and downs of the market.

Disadvantages of investing in the stock market include:

- **Stocks are volatile investments**. The price of a single stock can vary quite widely from day to day, and the factors that cause these price fluctuations are beyond the control of the investor.
- Buying a widely diversified basket of stocks can be difficult for all but the wealthiest investor. Small investors are better off buying a quality stock mutual fund. Mutual

funds pool the investments of many different people in order to buy a diversified set of stocks. This diversified approach helps to reduce the risk inherent in the stock market.

- As investors near retirement, the amount of stocks in the portfolio should be reduced. Investors who are close to retirement age can no longer afford to take chances with their money, and that means moving a significant portion of their retirement funds to safer and more stable investments.
- Buying and selling stocks costs money in the form of brokerage commissions, and many brokerage firms charge account maintenance fees as well. It is important to look for low cost alternatives when buying and selling stocks.

Factors Affecting the Stock Market

Movements in the stock market can be quite volatile and sometimes movements in share prices can seem divorced from economic factors. However, there are certain underlying factors which have a strong influence over the movement of share prices and the stock market in general.

1. **Economic growth**. Higher economic growth or better prospects for growth will help firms be more profitable because there will be more demand for goods and services. This will help boost company dividends and therefore share prices.

2. **Lower interest rates.** Lower interest rates can make shares more attractive for two reasons. Lower interest rates help boost economic growth making firms more profitable. Also lower interest rates make shares relatively more attractive than saving money in a bank or holding bonds. If bond yields fall, it may encourage investors to switch into shares which give a relatively better dividend.

3. **Stability**. Stock markets dislike shocks that could threaten economic stability and future growth. Therefore, they will tend to fall on news of terrorist attacks or spikes in the price of oil. They will also dislike political instability which may make it difficult to pursue strong economic policies.

4. **Confidence and expectations**. A key factor is the mood of investors. If they receive economic news that gives optimism then they are more likely to buy shares. If they receive bad news they will sell. This is why in the depth of a recession; stock markets can start to

rise. Investors are always trying to predict the future. Therefore if they feel the worst is over the stock market can rally – even when economic fundamentals remain poor.

5. **Bandwagon effect.** At times the stock market seems to over-react to certain events. Even today it remains a little mystery why the stock market fell so much – there was no economic problem. In fact the stock market soon recovered its lost ground. Part of the issue is that people follow the mood. When prices fall, people may feel the need to follow suit and get out of the market.

Related markets. Often investors have choices. For example, rather than investing in stock market, they could buy government bonds or commodities. If investors feel government bonds are overpriced and likely to fall, then the stock market can benefit as people move into shares

RECENT POLICY DEVELOPMENTS AND PROGRAMMES

SEBI along with other regulators and government have initiated number of policies and programmes during the financial year 2008-09 in order to improve the efficiency of operations in capital market. Basically these measures are aimed at protecting the interests of the investors. Major policy developments pertaining to capital market are enumerated below.

a) Shareholding in stock exchanges: To encourage competition in the stock exchange space, SEBI board decided to enhance the shareholding in the stock exchanges from 5 percent to 15 percent in respect of six categories of share holders namely, public financial institutions, stock exchanges, depositories, clearing corporations, banks and insurance companies as on December 23,2008.

b) Securities Lending and Borrowing (SLB): In pursuant of the feedback from the market participants, the Securities Lending and Borrowing scheme was revised with effect from April 21, 2008.Key modifications include increasing the tenure of SLB, extending the duration of SLB sessions and allowing margins in SLB. The securities lending and borrowing scheme has the potential of taking the Indian stock market to great heights. But unfortunately this scheme till now has not been able to show its presence in the market to its fullest.

c) Guidelines in respect of exit option to Regional Stock Exchanges: Broad guidelines were issued by SEBI with the objective of providing an exit option to Regional stock exchanges

(RSEs) whose recognition was withdrawn or if renewal of recognition was refused by SEBI or for RSEs who would like to surrender their recognition. As per the SEBI guidelines such RSEs may be permitted to retain movable and immovable assets and to deal with such assets as they deem fit, subject to the compliance with SEBI norms in this regard.

d) Introduction of Direct Market Access (DMA): Direct Market Access allows brokers to offer his clients access to the exchange trading systems through broker's infrastructure without manual intervention by the broker. SEBI introduced DMA with a view to increase liquidity, to have more transparent trading and to reduce the risk of error associated with manual execution of client orders.

e) Margining of Institutional Trades in the Cash Market:

Margining for institutional trades was made mandatory by SEBI w.e.f April 21; 2008.This initiative by SEBI was to strengthen the risk management frame work in capital market operations. Margins have to be collected from institutional investors on a T + 1 basis and the institutional investors can maintain the entire margin in the form of approved securities.

f) Mandatory Permanent Account Number (PAN) Requirement: SEBI exempted investors residing in the state of Sikkim from the mandatory requirement of PAN for their investments in mutual funds.

g) Advertisement by Mutual Funds: Investments in mutual funds are subject to market risk and an investor has to read the entire offer document before going for such investments. Hence it was made mandatory by SEBI that such statement i.e statements appearing in clauses of 10, 13 and 14 of schedule VI of SEBI (Mutual Fund) Regulations 1996, on advertisement code should appear in all advertisements. However with effect from January 18, 2010 such advertisement should be printed in bold .This was because these statements were not often brought to the notice of investors due to the lengthy nature of mutual fund advertisements.

h) Application supported by blocked amount (ASBA) facility in public issues and right issues: In its endeavor to make the existing public issue facility more efficient SEBI has introduced the ASBA facility as on July 30th 2008.Such facility is made available to retail investors also. ASBA is an application containing an authorization to block the application money in the bank account, for subscribing to an issue. If an investor is applying through

ASBA, his application money shall be debited from the bank account only, if his/her application is selected for allotment.

i) Quarterly Reporting by Foreign Venture Capital Investors (FVCI): With effect from the quarter that ended in 31st March 2010, all FVCI operating in India have to submit quarterly reports with SEBI. The report is to be uploaded in the SEBI portal within 7 days from the end of each calendar quarter. This measure can be looked upon as one taken for bringing more transparency in the operations of FVCI.

CONCLUSION

Emerging markets have made dramatic progress during the last decade. However, in order to compete in the global economy stock markets in both developed and developing economies must continue to make changes in order to meet the needs of their stakeholders. These stakeholders include investors, issuers, shareholders, member firms, and also governments. Over the past ten years Indian Stock Market has witnessed many changes which are in line with the economic development of the country. Trading and settlement procedures have been improved and many new instruments have been introduced with an objective of meeting the varied preferences and risk appetite of Indian investors.. A code of corporate governance has been put in place and steps were taken to change the organizational structure of the stock exchanges. Considering all these factors along with the current economic development of the country, growth of Indian Stock would be tremendous in the coming years. However the market has to become further transparent and reliable with lesser volatility to attract more and more foreign capital inflows in to the country.

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