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CAPITAL MARKET AND IT'S ROLE IN INDIAN FINANCIAL SYSTEM

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Abstract: *Capital market is a market for long term funds. It refers to all facilities and institutional arrangements for borrowings and lending of medium term and long term fund. It deals not capital goods but concerned with rising of money capital for investment. In the capital market the supply of funds largely from individual savings, corporate savings, banks, insurance companies, specialized financing agencies and Government. The demand for long term capital comes mainly from private sector industries and Government. The researchers have presented Introduction and investment, Role of investment in economic development of the nation, Developments in the Indian capital markets, SEBI and the regulation of securities markets, Report of the committee under the chairmanship of Justice D.P. Wadhwa with an aim to know the role of capital market in India. This paper deals with and highlights the process of capital market reforms, Role of capital market, Importance and growth of capital market in India.*

Keywords*: Capital Market, SEBI, Investment, Securities Market, Market Reforms*

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INTRODUCTION

Capital market refers to the market for long-term funds for investment purposes. The capital market is the source of funds for corporates, governments and provides opportunities to savers to park their long-term savings. The capital market comprises of two segments- the primary and the secondary markets. The primary market allows the flow of long-term funds from the surplus sector to governments, corporates, banks and NBFCs. It helps in the creation of net fixed assets. Initial public offers (IPOs), private placements, rights issues, preferential issues are the important instruments of the primary market. In recent years, there is a considerable widening and deepening of the primary market with PSBs, financial institutions, PSUs, mutual funds entering the markets as borrowers and the merchant banks, investment and consulting agencies and registrars to the issues as the managers.

Broad term describing any market place where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. Financial Markets are typically defined by having transparent pricing, basic regulations on trading, costs and fees and market forces determining the prices of securities that trade. In economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them. The term "market" is sometimes used for what are more strictly exchanges, organizations that facilitate the trade in financial securities, e.g., a stock exchange or exchange in Finance, Financial Markets facilitate:

The raising of capital (in the Capital Markets)

The transfer of risk (in the Derivatives Markets)

The transfer of liquidity (in the Money Markets)

International trade (in the Currency Markets)

Capital market is the key driver of wealth creation and growth in many countries. The regulators financial institutions and most importantly the investors keep trade of the development in the global capital markets. It is estimated that the growth of global financial stock is estimated to $ 200 trillion by 2010. It is observed that the United States, Europe and Japan are the major contributors to the global financial stock. Due to the increasing depth in financial markets, both businessmen and investors are enthusiastic to enter capital markets and make profits. The U.S led the race with 37 percent share followed by the U.K, Japan and other developing countries. Capital market is a market for long term funds. It refers to all facilities and institutional arrangements for borrowings and lending of medium term and long term fund. It deals not capital goods but concerned with rising of money capital for investment. In the capital market the supply of funds largely from individual savings, corporate savings, banks, insurance companies, specialized financing agencies and Government. The demand for long term capital comes mainly from private sector industries. Capital markets have observed volatility of capital flows, contributing of financial developments in India have played a critical role is promoting industrialization, facilitating the mobilization of capital for large investments. A financial market consists of investors or buyers, sellers, dealers and brokers and does not refer to physical location. The participants are linked with formal trading rules and communication networks for originating and trading of financial services. Financial investments can be used to raise resources in the capital market. High net worth individuals, investors and corporate entities are engaged in purchase and selling of financial instruments in the capital market

OBJECTIVES OF THE STUDY

1. To Highlight the Role and Importance of Capital market in India
2. To know the Factors Responsible for Growth and Development of capital market
3. To know the Process of Reforms in the Indian capital market

RESEARCH METHODOLOGY

This study is based on secondary sources of information from Publications of various Institutes, Organisations, published newspapers, journals-online & printed, magazines, web sites, books. The information is collected from libraries and websites. The literature is cross checked and validated to gives the latest information.

ROLE AND IMPORTANCE OF CAPITAL MARKET IN INDIA

Capital market has a crucial significance to capital formation. For a speedy economic development adequate capital formation is necessary. The significance of capital market in economic development is explained below:-

Mobilisation of Savings and Acceleration of Capital Formation

In developing countries like India the importance of capital market is self-evident. In this market, various types of securities helps to mobilise savings from various sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.

Ready and Continuous Market

The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.

Technical Assistance

An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.

Raising Long - Term Capital

The existence of a stock exchange enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this dash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.

Foreign Capital

Capital markets makes possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalised Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.

Easy Liquidity

With the help of secondary market investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

Revival of Sick Units

The Commercial and Financial Institutions provide timely financial assistance to viable sick units to overcome their industrial sickness. To help the weak units to overcome their financial industrial sickness banks and FIs may write off a part of their loan.

Promotion of Industrial Growth

The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.

Reliable Guide to Performance

The capital market serves as a reliable guide to the performance and financial position of corporates, and thereby promotes efficiency.

Proper Channelization of Funds

The prevailing market price of a security and relative yield are the guiding factors for the people to channelize their funds in a particular company. This ensures effective utilisation of funds in the public interest.

Provision of Variety of Services

The financial institutions functioning in the capital market provide a variety of services such as grant of long term and medium term loans to entrepreneurs, provision of underwriting facilities, assistance in promotion of companies, participation in equity capital, giving expert advice etc.

Development of Backward Areas

Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long term funds are also provided for development projects in backward and rural areas.

FACTORS RESPONSIBLE FOR GROWTH AND DEVELOPMENT OF CAPITAL MARKET

Growth of Development Banks and Financial Institutions

For providing long term funds to industry, the government set up Industrial Finance Corporation in India (IFCI) in 1948. This was followed by a number of other development banks and institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, Foreign Investment Promotion Board in 1991, Over the Counter Exchange of India (OTCEI) in 1992 etc. In 1969, 14 major commercial banks were nationalised. Another 6 banks were nationalised in 1980. These financial institutions and banks have contributed in widening and strengthening of capital market in India.

Setting up of SEBI

The Securities Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992.

Increasing Awareness

During the last few years there have been increasing awareness of investment opportunities among the public. Business newspapers and financial journals (The Economic Times, The Financial Express, Business India, Money etc.) have made the people aware of new long-term investment opportunities in the security market.

Growing Public Confidence

A large number of big corporations have shown impressive growth. This has helped in building up the confidence of the public. The small investors who were not interested to buy securities from the market are now showing preference in favour of shares and debentures. As a result, public issues of most of the good companies are now over-subscribed many times.

Credit Rating Agencies

Credit rating agencies provide guidance to investors / creditors for determining the credit risk. The Credit Rating Information Services of India Limited (CRISIL) was set up in 1988 and Investment Information and Credit Rating Agency of India Ltd. (ICRA) was set up in 1991. These agencies are likely to help the development of capital market in future.

Growth of Mutual Funds

The mutual funds collects funds from public and other investors and channelize them into corporate investment in the primary and secondary markets. The first mutual fund to be set up in India was Unit Trust of India in 1964. In 2007-08 resources mobilised by mutual funds were Rs. 1,53,802 crores.

Development of Venture Capital Funds

Venture capital represents financial investment in highly risky projects with a hope of earning high returns After 1991, economic liberalisation has made possible to provide medium and long term funds to those firms, which find it difficult to raise funds from primary markets and by way of loans from FIs and banks.

Growth of Multinationals (MNCs)

The MNCs require medium and long term funds for setting up new projects or for expansion and modernisation. For this purpose, MNCs raise funds through loans from banks and FIs. Due to the presence of MNCs, the capital market gets a boost.

Growth of Underwriting Business

The growing underwriting business has contributed significantly to the development of capital market.

Growth of Merchant Banking

The credit for initiating merchant banking services in India goes to Grindlays Bank in 1967, followed by Citibank in 1970. Apart from capital issue management, merchant banking divisions provide a number of other services including provision of consultancy services relating to promotion of projects, corporate restructuring etc.

Growth of Entrepreneurs

Since 1980s, there has been a remarkable growth in the number of entrepreneurs. This created more demand for short term and long term funds. FIs, banks and stock markets enable the entrepreneurs to raise the required funds. This has led to the growth of capital market in India.

Legislative Measures

The government passed the companies Act in 1956. The Act gave powers to government to control and direct the development of the corporate enterprises in the country. The capital Issues (control) Act was passed in 1947 to regulate investment in different enterprises, prevent diversion of funds to non-essential activities and to protect the interest of investors. The Act was replaced in 1992.

REFORMS IN CAPITAL MARKET SINCE 1991

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

Dematerialisation of Shares

Dematerialisation of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds and debentures are allowed in demat form. The advantage of demat trade is that it involves Paperless trading.

Screen Based Trading

The Indian stock exchanges were modernised in 90s, with Computerised Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

Establishment of Securities and Exchange Board Of India (SEBI)

SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India. The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

Establishment of National Stock Exchange (NSE)

The setting up to NSE is a landmark in Indian capital markets. At present, NSE is the largest stock market in the country. Trading on NSE can be done throughout the country through the network of satellite terminals. NSE has introduced inter-regional clearing facilities.

Investor Protection

The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001: The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment. The IEPF will be utilised for promotion of awareness amongst investors and protection of their interests.

The National Securities Clearing Corporation Limited (NSCL)

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

Trading In Central Government Securities

In order to encourage wider participation of all classes of investors, Including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

Credit Rating Agencies

Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL– 1988), Investment Information and credit Rating Agency of India Ltd. (ICRA – 1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

Buy Back Of Shares

Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

Derivatives Trading

Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, Index Options.

Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

PAN Made Mandatory

In order to strengthen the “Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007.

Accessing Global Funds Market

Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIls), and Overseas Corporate Bodies (OCBs).

Mutual Funds

Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

Internet Trading

Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

Rolling Settlement

Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled' under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets.

The Clearing Corporation Of India Limited (CCIL)

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US $ forex spot and forward deals All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, white those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

REBOUND IN INDIAN CAPITAL MARKET

The factors that are responsible for rebound phenomenon in Indian Capital Market are as follows:

- Active FII buying.
- Active III (Indian Institutional Investor) buying.
- Favourable sovereign rating by leading credit rating agencies like S&P, Moody’s, etc.

- Favourable monsoons fuelling adequate demand for goods and services in the economy.
- Favourable political conditions.
- Strong foreign exchange reserve position.
- Strong fundamentals of basic and other industrial segments such as steel, FMCGs etc.
- Forecasts of better prospects in future.
- Strong macro-economic aggregates.
- Active participation of retail investors with renewed vigor.

CONCLUSION

Capital market is playing its important role in the development of Indian economy. Indian capital market suffered bruises in the last part of the nineties owing to the manipulative trade practices of unscrupulous brokers and other participants, it has been witnessing fine times in the recent past, thanks to many favourable conditions contributing to it. With the kind and the quality of human skills possessed by India's financial Industry, it is quite imperative that there is need to provide sound capital foundation for the stock market. However, it is important to note that the stock trading is not a panacea for all that ails the Indian stock market if the recent experience of some of corporate and banks abroad is of any indication. It is to be noted with happiness that Government of India has successfully introduced the derivative trading in the stock exchanges. There are very many issues, which require immediate and urgent attention of the planners concerned.

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