



Capital market in India

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Abstract

In India, the history of capital markets dates back to the 18th century when East India Company securities traded the country. The present study is largely based on the available secondary data. The statistical data regarding growth of the capital markets was available from various websites. Capital markets help to channelize surplus funds into productive use. Generally, this market trades mostly in long-term securities. The important divisions of the capital market are stock market, bond market and primary, secondary markets. Primary markets deal with the trade of new issues of stocks and other securities, whereas secondary market deals with the exchange of existing or previously-issued securities.

Keywords: Capital Markets, Long-term Securities, Stock Exchange, CCI, SEBI

Introduction

Capital market in any country plays a pivotal role in the growth of economy and meeting country's socio economic goals. They are an important constituent of the financial system, given their role in the financial intermediation process and capital formation of the country. The importance of the capital market cannot be underemphasized for developing economy like India which needs significant amount of capital for the development of strong infrastructure.

Capital market is the financial market for the buying and selling of the long term debt or equity backed securities. The market channels the wealth of savers to those who can put it to long term productive use. Modern capital markets are hosted on computer based electronic trading system which can be accessed by entities within the financial sector.

The capital market can be divided into:

1. **Primary Market:** It deals with issue of new securities. Companies, government, and public sector institutions can obtain funds through sale of new stock or bonds issue.
2. **Secondary Market:** It is also called liquid market. In this market the securities are sold by or transferred from one investor to another. Thus, this market gives liquidity to the long term securities.

Capital market deals with medium term and long term funds. It refers to all facilities and the institutional arrangements for borrowing and lending term funds (medium term and long term). The demand for long term funds comes from private business corporations, public corporations and the government. The supply of funds comes largely from individual and institutional investors, banks and special industrial financial institutions and Government.

Economic growth needs sound financial system which further requires the well-developed financial market. So, if country wants constant economic growth it has to develop its financial market. Emerging economies like India depends heavily on

the banking system for financing its capital needs. But banks which are highly protected in India hardly fulfill its funding requirements. Thus, there is the need to develop its capital market especially its bond market which is underdeveloped because of policies constraint.

Our finding is that during the first and second five year plans, the Government emphasized on the development of agriculture and public undertakings. The Public sector undertaking was healthier than Private undertakings, but shares were not listed in the stock exchange. More over controller of Capital Issue (CCI) closely supervised everything. A number of investors were interested to invest their savings in debentures instead of company deposits.

We conclude that Capital markets were not well organized and developed during the British rule. But in the present scenario, we find that Capital markets are well developed after the introduction of SEBI. Through provision of long term loans, the capital market brings about effective functioning of various sectors of the economy. A sound and efficient capital market is one of the most instrumental factors in the economic development of a nation.

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:-

1. Mobilization 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 help to mobilize 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.

2. 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.

3. 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 mobilizing funds for investment in the corporate securities.

4. 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.

5. 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.

6. Reliable Guide to Performance

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

7. 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 utilization of funds in the public interest.

8. 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.

9. 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.

10. 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 liberalized 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.

11. 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.

12. 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.

Analysis

Primary market facilitates government as well corporate in raising capital to meet their requirements of capital expenditure and/or discharge of other obligation such as exit opportunity for venture capitalist/ Private Equity firm. The most common primary mechanism for raising capital is an Initial Public Offer (IPO), under which shares are offered to common public as a precursor to the trading in secondary market of an exchange. When securities are exclusively offered to the existing shareholders of company, as opposed to the general public it is called Rights Issue. Another mechanism whereby a listed company can issue equity shares, fully and partly convertible debentures which can be converted into equity shares later on, to a Qualified Institutional Buyer (QIB) is termed as Qualified Institutional Placement.

Table 1: Resource Mobilization through Primary Market

	2007-08	2008-09	2009-10	2010-11	2011-12
Debt	1603	1500	2500	2,245	4791
Equity	54,511	2,082	46,737	46,678	11647
Private placement	118,485	173,281	212,635	147,400	156,634

(Source: SEBI)

The Indian capital primary market showed a skewed growth. The heat of the financial crisis 2008 was also felt by the primary market when companies put public offer on hold and preferred private as important source of funds mobilization which accounted for about 95% of the total funds. The negative impact of current recession and much awaited reforms could also be observed for the financial year 2011-12. It could be observed that primary debt market in India is not yet mature which range between 1 to 2%. Private placement has been the most popular source of raising funds from the primary market by the companies in India which account for about average 76%.

Mutual Funds play an important role in financial services by offering diversification, liquidity and professional management at an affordable price. The Indian Mutual Fund industry consists of 44 players. In addition to advance tax commitments adverse interest rate scenario, slowing growth in India and concerns of global recession were other important reasons that led to the downfall.

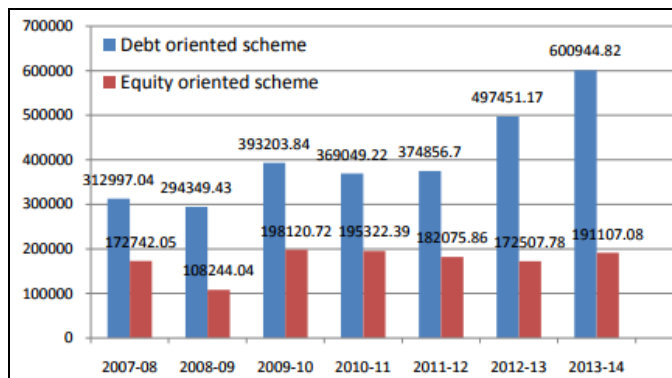


Fig 1: Trend of Mutual Fund Investment in Equity and Debt Oriented scheme for the Period 2007-08 to 2013-14 (source: SEBI)

Throughout the period from 2007-08 to 2013-14, investors have shown greater confidence in the debt oriented scheme as these are the regular source of income and investors in India are risk averse. Also, the difference in the amount invested in the debt oriented scheme has increased considerably from the year 2012-13 onwards.

Capital market consists of primary markets and secondary markets. Primary markets deal with trade of new issues of stocks and other securities, whereas secondary market deals with the exchange of existing or previously-issued securities. Another important division in the capital market is made on the basis of the nature of security traded, i.e. stock market and bond market.

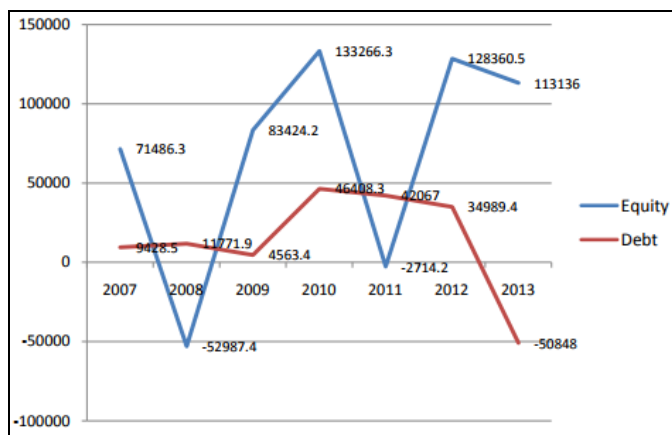


Fig 2: Trend of FIIs investment in Debt and Equity market from 2007-13 (source: SEBI)

The foreign institutional investors have always favored investment in equity market over the debt market but whenever there is crisis in the economy then they tend to prefer debt market over the equity market. As we can see in the above figure that in 2008, investment in the equity market was negative whereas in case of bond it was low but positive but as the economy started recovering, the investment in equity market tend to higher than the investment in the debt market.

Issues and Challenges of Indian Capital Market

Opening of the financial markets will result in competition

and greater efficiency. However, foreign participation will bring increased risk and exposure. Stability is thus need for financial markets for which safeguarding mechanism need to be established. The equity market in India is extremely vibrant but equity based funding solely, cannot lead the economy to growth. The debt market remains underdeveloped with a huge potential for increased activity. A strong hand is required to drive the long term financing of infrastructure, housing and private sector development. The road ahead for deepening the capital market need to be paved by the strong linkage between development of economy and the financial system. A greater measure of transparency is also required to built regulating procedures, to bring in a new dimension to financial market and take it to the next level.

One of the challenges before the Indian capital market is expanding the investor base and provide them access to high quality financial service. With a population of more than a billion, a mere 1% of population participates in capital market and of that only a fraction is active. Investor participation is very shallow considering the size of Indian economy Trading volume in Indian capital market are lower as compared to other markets such as US, China, UK, Germany etc. Another Challenge faced by the investor is the cost involved in trading, which are comparatively higher in India, than in developed markets.

Conclusion

India being an emerging economy needs innovations and reforms in the financial market. Innovation and reforms not only add value in the existing technology and system but also lead to decrease in the cost of capital and mitigate the risk exposure of the capital market instruments. No doubt that there is a positive correlation between the finance and the economic growth of the country.

Also, India has a huge market for the infrastructure which requires huge funds. The creation of deep and innovative bond market can fill this gap. Steps have been taken up to develop the equity market but there is lots to be done in case of the bond market development. Reforms need to be initiated, bottlenecks need to be removed, policies need to be changed to deepen the bond market in India and to make it as competitive as the world best bond markets.

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