ROLE OF CAPITAL MARKET IN DEVELOPING ECONOMY

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ABSTRACT
Capital Markets are defined as markets in which money is provided for period longer than a year. Capital markets have numerous participants including individual investors, institutional investors such as pension funds and mutual funds, municipalities and governments, companies and organizations and banks and financial institutions.

Capital markets typically involve issuing instruments such as stocks and bonds for the medium-term and long-term. In this respect, capital markets are distinct from money markets, which refer to markets for financial instruments with maturities not exceeding one year.

Capital market helps in capital formation. Through mobilization of ideal resources it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation.

It facilitates and promotes the economic growth by mobilizing resources and diverting them in productive channels. Various functions and significance of Capital Market are Link between savers and investors, encouragement to saving, encouragement to investment, and stability in security prices.

There are various instruments which are operating in the market for mobilizing fund, They are debt instruments, shares, derivatives products, debentures, preference shares etc.

Capital market plays an important role in formation and working of economy. It helps in increasing capital formation, regulation over the resources in a qualitative manner, raises resources for longer period of time, enhances production and productivity, provides an alternative source of long term finance for long term investment and forms an important source in mobilizing idle savings from the economy.

Keywords: Capital Market; Economy

INTRODUCTION
Capital Markets are the financial markets for the buying and selling of long-term debt or equity-backed securities. These markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.

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Capital Markets are defined as markets in which money is provided for period longer than a year. Capital markets have numerous participants including individual investors, institutional investors such as pension funds and mutual funds, municipalities and governments, companies and organizations and banks and financial institutions.
The size of a nation’s capital markets is directly proportional to the size of its economy. The United States, the world’s largest economy, has the biggest and deepest capital markets. Capital markets are increasingly interconnected in a globalized economy, which means that ripples in one corner can cause major waves elsewhere. The drawback of this interconnection is best illustrated by the global credit crisis of 2007-09, which was triggered by the collapse in U.S. mortgage-backed securities. The effects of this meltdown were globally transmitted by capital markets since banks and institutions in Europe and Asia held trillions of dollars of these securities.

Some of the examples of capital markets transaction are as under:

**A Government Collecting Money on the Primary Markets**

When a government wants to raise long term finance it will often sell bonds to the capital markets. In earlier years, many governments were using investment banks to organize the sale of their bonds. The leading banks would underwrite the bonds, and would often head up a syndicate of brokers, some of whom might be based in other investment banks. For developing countries, a multilateral development bank would provide an additional layer of underwriting, resulting in risk being shared between the investment bank(s), the multilateral organization, and the end investors.

**A Company Collecting Money on the Primary Markets**

When a company wants to raise money for long term investment, one of its first decisions is whether to do so by issuing bonds or shares. If it chooses shares, it avoids increment in debt, and in some cases the new shareholders may also provide non monetary help, such as expertise or useful contacts. On the other hand, a new issue of shares can dilute the ownership rights of the existing shareholders, and if they gain a controlling interest, the new shareholders may even replace the existing senior managers in the organization. From an investor's point of view, shares offer the potential for higher returns and capital gains if the company does well. Conversely, bonds are safer if the company does poorly, as they are less prone to severe falls in price, and in the event of bankruptcy, bond owners are usually paid before shareholders.

**Trading on the Secondary Markets**

Most capital market transactions take place on the secondary market. On the primary market, each security can be sold only once, and the process to create batches of new shares or bonds is often lengthy due to regulatory requirements. On the secondary markets, there is no limit on the number of times a security can be traded, and the process is usually very quick. With the rise of strategies such as high-frequency trading, a single security could in theory be traded thousands of times within a single hour. Transactions on the secondary market don't directly help raise finance, but they do make it easier for companies and governments to raise finance on the primary market, as investors know if they want to get their money back in a hurry, they will usually be easily able to re-sell their securities. Sometimes however secondary capital market transactions can have a negative effect on the primary borrowers - for example, if a large proportion of investors try to sell their bonds, this can push up the yields for future issues from the same entity.

**OBJECTIVE OF THE STUDY**

Whether Developing Market Is Affected As They Are Not Advanced

1. Advantages of the capital market to ensure proper utilization of financial resources.
2. Whether it provides access to the foreign capital to local industry.
3. Does capital market plays a constructive role in development of an economy
Working of Capital Market

Companies take the help of capital markets to raise money for projects by issuing stock IPOs, bonds and short-term money market securities. Individual investors who wish to earn interest or dividend on their savings can meet the companies who are looking to raise funds through issue of securities.

Illustration of how a corporate bond moves through capital markets

Suppose xy Co. needs to raise INR 1000. xy Co. offers a 10-year bond on the bond market with a par value of INR 1000. The bond is purchased by someone wishing to earn interest on the INR 1000 that they have available. xy Co. receives the INR 1000 in cash and the investor receives a bond and the promise of repayment plus interest. If the bondholder later decides he no longer wants the bond, he can sell it to another investor in the marketplace.

To illustrate using stocks, suppose xy Co. decided to raise more funds by issuing ten new shares of stock for INR100 per share. xy Co. offers these shares in the market and someone purchases all ten for INR1000 total. This time, the investor obtains stock certificates giving him partial ownership of the company. X y Co. gets the INR1000 in funds they wanted to raise. As in the example above, should this investor wish to no longer hold these stocks, he can sell them to another investor in the stock market for the current market price. Should the company have extra cash, it could buy the stock back as well.

Types of Instruments

The capital market, as it is known, is that segment of the financial market that deals with the effective channeling of medium to long-term funds from the surplus to the deficit unit. The process of transfer of funds is done through instruments, which are documents (or certificates), showing evidence of investments. The instruments traded (media of exchange) in the capital market are:

1. Debt Instruments: A debt instrument is used by either companies or governments to generate funds for capital-intensive projects. It can be obtained either through the primary or secondary market. The relationship in this form of instrument ownership is that of a borrower – creditor and thus, does not necessarily imply ownership in the business of the borrower. The contract is for a specific duration ranging from 3 to 25 years and interest is paid at specified periods as stated in the agreement. The principal sum invested, is therefore repaid at the expiry of the contract period with interest either paid quarterly, semi-annually or annually.

2. Equities (also called Shares): This instrument is issued by companies only and can also be obtained either in the primary market or the secondary market. Investment in this form of business translates the ownership of the business as the contract stands in perpetuity unless sold to another investor in the secondary market. The investor therefore possesses certain rights and privileges (such as to vote and hold position) in the company. The investor in debts is entitled to interest, which must be paid whereas in the case of equity holders they receive dividends, which may or may not be declared. The risk factor in this instrument is high and thus yields a higher return (when successful).

3. Preference Shares: This instrument is issued by corporate bodies and the investors rank second (after bond holders) on the scale of preference when a company goes under. The instrument possesses the characteristics of equity in the sense that when the authorised share capital and paid up capital are being calculated, they are added to equity capital to arrive at the total. Preference shares can also be treated as a debt instrument as they do not confer voting rights on its holders and have a dividend payment that is structured like interest (coupon) paid for bonds issues.

4. Derivatives: These are instruments that derive from other securities, which are referred to as underlying assets (as the derivative is derived from them). The price, riskiness and function of the derivative depend on the underlying assets since whatever affects the underlying asset must affect the derivative. The derivative might be an asset, index or even situation. Derivatives are mostly common in developed economies. Some examples of derivatives are Mortgage-Backed Securities (MBS),
Asset-Backed Securities (ABS), Futures, Options, Swaps, Rights, and Exchange Traded Funds or commodities.

**Resources Mobilisation**

Capital markets play an important role in mobilising resources, and diverting them in productive channels. In this way, it facilitates and promotes the process of economic growth in the country. Various functions and significance of capital market are discussed below:

1. **Link between Savers and Investors:** The capital market functions as a link between savers and investors. It plays a key role in mobilizing the savings and diverting them into productive investment. In this way, capital market plays an important role in transferring the financial resources from surplus and wasteful areas to deficit and productive areas, thus increasing the productivity and prosperity of the country.

2. **Encouragement to Saving:** With the development of capital, market, the banking and non-banking institutions provide facilities, which encourage people to save more. In the less-developed countries, in the absence of a capital market, there are very little savings and those who save often invest their savings in unproductive and wasteful directions, like land, gold, and jewellery.

3. **Encouragement to Investment:** The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and nonbanks financial institutions. Various financial assets, *e.g.*, shares, securities, bonds, etc., induce savers to lend to the government or invest in industry. With the development of financial institutions, capital becomes more mobile, interest rate falls and investment increases.

4. **Promotes Economic Growth:** The capital market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions of the capital market, like nonbank financial intermediaries, allocate the resources rationally in accordance with the development needs of the country. The proper allocation of resources results in the expansion of trade and industry in both public and private sectors, thus promoting balanced economic growth in the country.

5. **Stability in Security Prices:** The capital market tends to stabilise the values of stocks and securities and reduce the fluctuations in the prices to the minimum. The process of stabilisation is facilitated by providing capital to the borrowers at a lower interest rate and reducing the speculative and unproductive activities.

6. **Benefits to Investors:** The credit market helps the investors, *i.e.*, those who have funds to invest in long-term financial assets, in many ways:
   1. It brings together the buyers and sellers of securities and thus ensure the marketability of investments,
   2. By advertising security prices, the Stock Exchange enables the investors to keep track of their investments and channelize them into most profitable lines,
   3. It safeguards the interests of the investors by compensating them from the Stock Exchange Compensating Fund in the event of fraud and default.

**CASE STUDY**

A case study was carried out on Investment Avenues based on people of different age group and gender by International Journal of Research in Commerce and Management. Some of the extracts from the case study are shown below for better understanding:

**Age and Investor Awareness**

The relation between age and awareness of investors, the age-wise distribution of investment avenues with high awareness and also with low awareness amongst the investors is analyzed hereunder.
It may be seen from table 1 that the respondents are almost equally distributed among the different age group while claiming their high level of awareness about these avenues. Therefore, the age of investor cannot be taken to influence their level of awareness.

**Table 1. Age-Wise Distribution of Investment Avenues with High Awareness**

<table>
<thead>
<tr>
<th>Age in Year</th>
<th>Bank In Deposits</th>
<th>Real Estate</th>
<th>SSS</th>
<th>LIC</th>
<th>Bullion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 30</td>
<td>74.6</td>
<td>92.1</td>
<td>65.1</td>
<td>63.5</td>
<td>77.8</td>
</tr>
<tr>
<td>31-40</td>
<td>78.4</td>
<td>83.0</td>
<td>72.1</td>
<td>70.5</td>
<td>69.3</td>
</tr>
<tr>
<td>41-50</td>
<td>82.8</td>
<td>74.5</td>
<td>85.5</td>
<td>83.5</td>
<td>65.5</td>
</tr>
<tr>
<td>51-60</td>
<td>78.8</td>
<td>76.0</td>
<td>68.5</td>
<td>69.9</td>
<td>69.9</td>
</tr>
<tr>
<td>Above 60</td>
<td>81.0</td>
<td>77.4</td>
<td>78.5</td>
<td>86.9</td>
<td>71.4</td>
</tr>
</tbody>
</table>

It may be observed from table 1 that there are no significant differences in the level of awareness between male and female investors of all investment avenues.

The difference between male and female investor is hardly 4% for any avenues and it can be insignificant for a sample size of 526.

**Table 2. Age-Wise Distribution of Investment Avenues with Low Awareness**

<table>
<thead>
<tr>
<th>Corporate deposits</th>
<th>Corporate Bond</th>
<th>Mutual Fund</th>
<th>Equity Share</th>
<th>Preference share</th>
</tr>
</thead>
<tbody>
<tr>
<td>44.4</td>
<td>31.7</td>
<td>38.1</td>
<td>39.7</td>
<td>31.7</td>
</tr>
<tr>
<td>42.0</td>
<td>39.8</td>
<td>31.8</td>
<td>25.0</td>
<td>34.1</td>
</tr>
<tr>
<td>39.3</td>
<td>29.0</td>
<td>29.0</td>
<td>28.3</td>
<td>26.2</td>
</tr>
<tr>
<td>26.7</td>
<td>28.1</td>
<td>17.8</td>
<td>19.2</td>
<td>17.1</td>
</tr>
<tr>
<td>32.1</td>
<td>22.6</td>
<td>32.1</td>
<td>27.4</td>
<td>28.6</td>
</tr>
</tbody>
</table>

**Gender and Investor Awareness**

To examine whether any relation exist between the gender and the level of investor awareness, the gender wise distribution of the investor respondents of different investment avenues, which are divided into avenues with high awareness and those with low awareness, is analyzed. The relevant information is furnished in table 3 and 4.

**Table 3. Gender-Wise Distribution of Investment Avenues with High Awareness**

<table>
<thead>
<tr>
<th>Gender</th>
<th>BD</th>
<th>RE</th>
<th>SSS</th>
<th>LIC</th>
<th>Bullion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>80.7</td>
<td>78.0</td>
<td>76.3</td>
<td>75.8</td>
<td>68.9</td>
</tr>
<tr>
<td>Female</td>
<td>77.3</td>
<td>81.0</td>
<td>72.4</td>
<td>75.5</td>
<td>71.8</td>
</tr>
</tbody>
</table>

**Source:** Data Source Population Survey

It may be observed from table 3 that there are no significant differences in the level of awareness between male and female investors of all investment avenues.

The difference between male and female investor is hardly 4% for any avenues and it can be insignificant for a sample size of 526.

**Table 4. Gender-Wise Distribution of Investment Avenues with Low Awareness**

<table>
<thead>
<tr>
<th>Gender</th>
<th>CD</th>
<th>CB</th>
<th>MF</th>
<th>ES</th>
<th>PS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>38.8</td>
<td>32.2</td>
<td>32</td>
<td>30.9</td>
<td>28.4</td>
</tr>
<tr>
<td>Female</td>
<td>20.9</td>
<td>20.9</td>
<td>21.0</td>
<td>20.9</td>
<td>20.9</td>
</tr>
</tbody>
</table>

**Source:** Data Source Population Survey

It may also be seen from table 4 that there are no significant differences in the level of awareness between male and female investors of all investment avenues.

From table 3 and 4, it is very clear that the gender of the investor has no effect or influence on his or level of awareness about any investment channel.
Capital Markets' Role in an Economy

Capital Market plays an important role in the formation and working of economy. Some of the key roles of Capital markets are as under:

1. Capital market helps in capital formation. Through mobilization of ideal resources it generates savings; the mobilized savings are made available to various segments such as agriculture, industry, etc. This helps in increasing capital formation.

2. Capital market not only helps in fund mobilization but also helps in proper allocation of resources. It can have regulation over the resources so that it can direct funds in a qualitative manner.

3. Capital market raises resources for longer periods of time thus providing an investment avenue for people who wish to invest resources for a long period of time. It also provides suitable interest rate returns to the investors. Instruments such as bonds, equities, units of mutual funds, insurance policies, etc. definitely provides diverse investment avenue for the public.

4. Capital market enhances production and productivity in the national economy. As it makes funds available for a longer period of time, the financial requirements of business houses are thus met with the help of capital market. With the need for research and development in capital market, it helps in the increase of production and productivity in economy by generation of employment and development of infrastructure.

5. It provides an important alternative source of long-term finance for long-term productive investments which indirectly helps in diffusing stress on the banking system by matching long-term investments with long-term capital.

6. Capital market forms an important source in mobilizing idle savings from the economy. It mobilizes funds from people for further investments in the productive channels of an economy which amounts to activation of ideal monetary resources and putting them in proper investments.

7. It helps in promoting public-private sector partnerships to encourage participation of private sector in productive investments. Pursuit of economic efficiency shifting driving force of economic development from public to private sector to enhance economic productivity has become unavoidable as resources continue to diminish.

8. It helps in assisting the Government to close the resource gap, and complement its effort in financing essential socio-economic development, by raising long-term project based capital.

9. Capital Market improves the efficiency of capital allocation through competitive pricing mechanism for better utilization of scarce resources for increased economic growth.

REMARKS

The lack of advanced and vibrant capital market can lead to underutilization of financial resources. The developed capital market also provides access to the foreign capital for domestic industry. Thus capital market definitely plays a constructive role in the overall development of an economy.

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