ROLE OF CAPITAL MARKET IN INDIAN FINANCIAL SYSTEM - PAST, PRESENT AND FUTURE

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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 a aim to know the role of capital market in India.

Keywords: Capital Market; SEBI; Investment

INTRODUCTION

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 and Government¹.

The commercial banks, LIC and GIC are largely interested in Government securities, debentures and provident funds is another source of savings but their investments are mostly

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in Government securities. The institutions like IFCI, ICICI, IDBI and UTI are providing long term capital to the private sector. The rapid expansion of the corporate and public sectors necessitates the development of capital market in India. 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**

- To Review The Capital Market Developments In India,
- To make appropriate suggestions for strengthen of capital market in Indian Financial system

**A REVIEW OF LITERATURE**

**Role of Investment in Economic Development in India**

Though people tend to invest for numerous reasons, National Council of Applied Economic Research (NCEAR), India with the sponsorship of Securities and Exchange Board of India (SEBI) has conducted a research on household savings and investments. In their report for the year 2011, they have mentioned the following prime reasons for people to invest.

1. Securing post retirement life,
2. Children education and marriage,
3. Creation of wealth

Economic development of a nation will take place only when that nation is vibrant in at least in one of the sectors of Agriculture, Manufacturing and Service, if not in all of them. Along with men and machinery, investment in the form of capital is an important factor of production for an economic activity. In fact, it is not possible to arrange other factors of production without capital.

Some nations in this world are not blessed with abundance of natural resources. But still, only because of investment on industry and on technology, they became economic superpowers. One can take Japan as an example to prove this point. Japan is a tiny nation which is subjected to a variety of natural calamities like earth quake and tsunami. It does not have enough of fertile land due to atom bombs that were dropped on its soil. But due to the investments made on technology front, it is able to become world fourth largest economy. (World Bank Report 2012). Surprisingly, world’s most two papules nations; China and India did not invest to the required levels. As a result, they have become the global destinations for outsourcing and making goods for the companies of other nations. As per the global brand index, which is compiled by brandinex.com, China and India put together did not have at least one global brand where as small nations like Finland and Denmark are having number of brands. India, at least able to realize this fact that it has global brand product and invested heavily on information technology education and infrastructure which helped it become one of the leading nations in the world on the front of information technology and the sector is
generating huge amount of revenues to the nation both in domestic as well as foreign currency. Some nations have immense potentiality to become global economic super powers by manufacturing goods and by creating their own brands. But, their economic policies which are not conducive for private investment are hampering their growth. Ruchir Sharma (2011) in his book Breakout Nations supported this point by taking examples of Russia and China. They both did not encourage private investment for long. They felt every business organization must be in the hands of Government. As a result, though these two nations are having manufacturing capabilities, they could not produce any global consumer brand products. He further added that only after opening up of economies for private investors, along with Brazil and India, these two became raising economic powers and together called as BRIC nations. East Asian nations like Malaysia and Thailand have invested on tourism infrastructure and as results they are able to attract domestic and foreign tourists which in turn developed their economies.

A similar observation was made by Easterly, W. and Rebelo, S., (2011) in their research on the role of investment on infrastructure and its impact of economic development. They stated that the investment on infrastructure by Singapore attracted not only tourists, but also many Multi National Companies to set up their offices which resulted in the economic development of Singapore. On the other hand, African most of the African nations like Nigeria, Uganda, Rwanda and other did not invest on any of the sectors and as a result, their people are not having any job to do in their hand and hence either they are suffering with internal wars or their people are turning into international pirates.

Where do people Invest?
The Individuals may invest their money in

1. Land
2. Housing
3. Gold and Other Precious Metals
4. Portfolio diversification
5. Inflation hedge
6. Currency hedge
7. Risk management
8. Demand and supply
9. Financial Assets like in Cash or cash equivalent and in Bond, Debenture or any other Corporate Security

Developments in Indian Capital Markets
The Indian securities market has a history of nearly 150 years. The Bombay Stock Exchange, the Ahmedabad Stock Exchange and the Calcutta Stock Exchange are among Asia’s oldest stock exchanges. However, the modern era in the Indian securities market and its transformation began with the economic reforms in the early 1990s when the government initiated a systemic shift to a more open economy with greater reliance on market forces in which the private sector plays an important role. The Indian securities market gained greater importance and the SEBI Act, 1992 established the Securities and Exchange Board of India
(SEBI) as a statutory authority to oversee the securities market in India. SEBI is mandated with three principal objectives:

(i) To protect the interests of investors in securities;

(ii) To promote the development of the securities market; and

(iii) To regulate the securities market.

Before the establishment of SEBI, activities in securities markets lacked a comprehensive regulatory framework and were opaque. Since the establishment of SEBI, the securities market in India has developed significantly. It led to a successful transition from a highly controlled merit based regulatory regime to market-oriented disclosure-based regulatory regime. SEBI's focus has been on developing a well regulated modern securities market in India by adopting global standards and international best practices. With the implementation of various rules and regulations prescribed by SEBI, access to information has increased; the risk of defaults has gone down and overall governance and ambience have become conducive for protection of investors’ interests and the development of the securities market in India.

Development of Primary Securities Market

The development of primary markets in India has followed a unique pattern. While the number of issues in the early nineties was very high (more than 1,000), the aggregate resources mobilized was not significant. However, in the first decade of the 21st century the trend gradually reversed; the number of issues remained low (less than 200) but the amount mobilized increased significantly. The only exception to this trend was during 2008–09 when the US was hit by the subprime crisis leading to a global financial crisis and the cascading effect was felt in emerging markets. Where in 2007–08 an amount of 870.29 billion was mobilized through 124 public and rights issues, the amount mobilized fell to a mere 162.20 billion through 47 issues in 2008–09. With the gradual waning of the sub-prime crisis in 2009–10, the market regained confidence and an amount of 575.55 billion was mobilized through 76 issues.

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Growth of Market Capitalization and Turnover

Market capitalization has gone through ups and downs. In the earlier years of this decade, there was a sharp fall in the market capitalization of both exchanges. From 2003–04, the downtrend was reversed and the market value of listed stocks again started soaring. The market capitalization of the BSE increased exponentially by 575 per cent, from 9,128 billion at the end of March 2000 to 61,656 billion at the end of March 2010. During the same period, the market capitalization of the NSE also increased by 489 per cent, from 10,204 billion to ` 60,092 billion. The annual turnover in the cash segments of BSE and NSE reflected the same trend. After 2000–01, there was a sharp fall in the turnover and this trend continued for some years. Later, the situation gradually improved. By the end of March 2010, the annual turnover of the cash segment of the BSE was 13,788 billion and that of the NSE was 41,380 billion.

Growth of Intermediation Industry

The quantitative transformation of the Indian securities market has happened with the help of a growing intermediation industry. While the number of brokers increased from 9,192 in 2000 to 9,816 in 2010, that of sub-brokers increased by more than fourteen-fold from 5,675 to 75,744 during the same period signifying the reach and expansion of the Indian securities market. Supplementing this expansion during the past decade, the number of depository participants increased from 205 to 758, the number of portfolio managers increased from 23 to 243, the number of venture capital funds increased from 22 to 160 and foreign venture capital funds emerged as a new class of participants in the market with their number increasing to 143 by 2010. On the other hand, dematerialisation led to a reduction in the number of registrars and transfer agents from 242 to 74 during the past decade.

Expansion and Globalisation of Indian Securities Markets

India is home to more than 4,900 domestically-listed companies in the BSE, making India second only to the US in terms of number of domestically-listed companies. With the changed dynamics of global financial flows, emerging markets are attracting an increased amount of foreign funds. In India, the securities market has developed at a rapid pace. The domestic mutual fund industry has been expanding by introducing new products and has been receiving increased allocation of the financial savings of domestic households. The regulatory framework is in place for collective investment schemes, domestic venture capital funds and foreign venture capital investors. The transformation has manifested itself in the higher ranking of the Indian securities markets in the global arena.

Market Regulations

The SEBI Act empowers SEBI to frame regulations to regulate intermediaries and to ensure disclosures and investor protection by listed companies. SEBI has framed a number of regulations for different intermediaries. Under these regulations, SEBI prescribes eligibility norms, viz., physical infrastructure, professional competencies and minimum capital requirements for registering intermediaries. SEBI also prescribes a code of conduct and
disclosure and compliance requirements. SEBI monitors the activities of registered entities and takes penal action if the regulations are violated. To ensure that the perimeter of SEBI's regulations are in tune with the dynamic nature of the securities market, SEBI reviews its regulations from time to time and prescribes new regulations to regulate new activities in the market. The regulatory framework for intermediaries, which has been evolving since 1992, has stood the test of time and has been able to ensure, by and large, quality intermediation services in the market.

**SEBI and the Regulations of Securities Markets**

From its inception, SEBI has endeavoured to develop the securities markets and simultaneously set up a benchmark in market regulation. Following is a brief review of SEBI's achievements in the field of market regulation in the past decade.

**Streamlining Capital Raising**

SEBI over time has introduced a number measures aimed at enhancing efficiency and optimizing the cost of raising capital from the securities market. The transformation of the primary securities market has been on account of the introduction of the book building route for public issues, margining and proportional allotment for all categories of investors in book-built issues, mandatory IPO grading, qualified institutions placements (QIPs), fast-track issues, Applications Supported by Blocked Accounts (ASBA) and significant reduction in the timeline for rights issues and bonus issues.

**Reduction in Transaction Costs**

The growth in the categories of investors in the market has kept pace with the types of products. Transaction costs have come down on account of the reduction in rationalization of fees, commissions and market impact cost. The actual brokerage charged is as low as 0.10 per cent, suggesting a competitive brokerage industry. Entry load has been abolished for investment in mutual funds.

**Transparency**

SEBI's regulatory regime is primarily based on disclosures and transparency. To make the process of price discovery in the primary markets more transparent, SEBI introduced the book building process and mandated necessary disclosures in the offer documents. In the secondary markets, transparency is ensured by introduction of screen-based order matching system which makes the price and volume data instantly available to an investor in the remotest corner of the country.

**Disclosure-based Regulations**

The establishment of SEBI ushered disclosure-based regulation in the Indian securities market. Companies desiring to raise capital from the securities market through public issues are required to disclose all material information so as to facilitate informed investment decision-making. This mandate applies to companies that propose to list their securities, listed companies and all regulated entities.

**Promotion of Market Integrity**

The surveillance, investigation and enforcement capability of SEBI has been strengthened to deter violation of securities laws. To enhance the efficacy of the surveillance function, SEBI has put in place a comprehensive Integrated Market Surveillance System (IMSS) which generates alerts arising out of unusual market movements.
Investor Assistance and Education

SEBI has in place a comprehensive mechanism to facilitate redressal of grievances against intermediaries registered by it and against companies whose securities are listed or proposed to be listed on stock exchanges. SEBI has taken several steps to address structural weaknesses in the system to eliminate the root cause of complaints. SEBI has evolved a procedure where class action suits filed by investor associations in respect of violations will be reimbursed the cost of legal action. Investor education has received much attention in the recent past.

Adoption of International Standards

The legal and regulatory framework governing the Indian securities market complies substantially with the International Organization of Securities Commission's (IOSCO) Principles of Securities Regulation. The assessment of IOSCO Principles as regards regulation of the equity/corporate bond market by the Committee on Financial Sector Assessment (CFSA) has revealed an overall significant level of compliance.

Indian Capital Market- Major Issues

The Indian Capital Market has, over a period of time, undergone rapid structural transformation. During the last fifty years of 1947 to 1997, it has evolved itself from a dormant segment of the financial system to a highly active, dynamic, and volatile segment characterized by institutional buildup, technological advancement and modernization. With the vast and varied market reforms unleashed since 1992, primary market has emerged as a major source of funding for the corporate entities both in the public and private sectors and the secondary market has modernized itself through advance technology and transparent trading practices. The major issues confronting the Indian capital market are briefly presented below:

Investor Protection

Investors constitute the pillars of the capital market. It is imperative that adequate protection is provided to them. Some of the popular problems that are being faced by investors are as follows:

1. Vanishing Companies: Certain companies raised funds after taking advantage of market buoyancy and then desert investors as has happened in 1985-86. This menace of vanishing companies still haunts investors and has affected their psyche very much.

2. Lack of commitment: The incredibly lack of commitment shown by financial institutions and underwriters regarding the avoidance of project appraisal during the post-issue period in relation to mega issues in the eighties has considerably shaken the confidence of the investors.


4. Malasies like share price rigging and insider trading continue to afflict the Indian Capital Market, affecting the investors adversely.

5. Lack of necessary professional expertise and integrity on the part of merchant bankers and other market intermediaries. In many cases merchant bankers act hand-in-glove with companies to attract the gullible investors.
6. The defaults committed by some brokers in different stock exchanges have also adversely affected the confidence of investors causing occasional suspension of trading.

Recent Trends in Capital Market

Many instruments namely, secured premium notes, non convertible debentures, zero interest equity shares and fully convertible cumulative redeemable preference shares were introduced to suit the needs of investors and issuers/borrowers. The resources mobilized by these innovative financial instruments accounted for 38 percent of the total resource mobilization by non-government public limited companies in 2005.

The total amount of capital raised during 2004-05 through public and rights issues stood at Rs. 28256 crore indicate the revival of investors interest in the primary markets. The sector wise classification shows that the private sector dominated the resource mobilisation efforts in 2004-05 with 61 percent share in the total resource mobilized followed by the public sector with 39 percent. The abolition of capital issues control and the introduction of free pricing of issues made unprecedented upsurge of activity in the primary capital market. As a consequence, the public limited companies mobilised huge resources.

The SEBI guidelines ensure that only quality issues enter the market. The primary market has shown qualitative changes since the nineties. The share of private placement issues in total resource mobilization from the primary capital market has been increased. Resources mobilized from the international capital markets by way of FDRs/ ADRs, foreign currency convertible bonds and external commercial borrowings were also increased considerably.

REPORT OF THE COMMITTEE UNDER THE CHAIRMANSHIP OF JUSTICE D. P. WADHWA, FORMER JUDGE OF THE SUPREME COURT OF INDIA ON REALLOCATION OF SHARES IN THE MATTER OF IPO IRREGULARITIES

This is an executive summary of the Report of the Committee on reallocation of shares in the matter of IPO irregularities

Background

1. SEBI unearthed and investigated certain irregularities in Initial Public Offerings (IPO) from 2005.

The irregularities involved the following steps:

- Opening of a large number of DP (and bank) accounts in fictitious / benami names by certain individuals (“afferent accounts”)
- These accounts were controlled by and for the benefit of certain “key operators” and “financiers”.
- The funds used for subscription came from certain “financiers”.
- Applications were made using these afferent demat accounts and funds, in the retail quota of IPOs, so as to corner shares by using the favourable allotment chances for retail investors.

2. A Committee was set up under the Chairmanship of Justice D. P. Wadhwa, former Judge of the Supreme Court of India, to advise / recommend on the procedure of identification of persons who might have been deprived on account of such IPO irregularities and the manner in which reallocation of shares to such persons should take place.
Principles
The Committee after going through the terms of reference, background and analysis of the relevant data and facts came to a decision that the Committee needs to establish 3 principles as under:

a. To quantify the amount of unjust enrichment that has taken place, and which is the subject of reallocation.

b. To identify the genuine applicants who may be considered “deprived”.

c. To decide a basis on which the unjust enrichment is to be reallocated amongst the “deprived” applicants.

Unjust gains and holdings in frozen demat accounts.

- The Committee has observed that the reallocation amount to the deprived applicants must be paid out of moneys that must first be recovered from those who unjustly benefited such as the key operators and financers. The Committee has observed that the total unjust gains works out to about Rs. 95.69 Crores across the 21 IPOs under consideration. The Committee also observed that the quantum of unjust gains based on allotment to afferent accounts is approximately Rs. 95.69 Crores, of which Rs. 91.42 Crores were identified as belonging to shares that were transferred to key operators/financers.

- The Committee observed that the value of the holdings in the frozen demat accounts in both NSDL and CDSL of the key operators and financiers.

- SEBI may like to decide based upon the status of legal proceedings whether this amount is immediately recoverable and if so whether it can be distributed among the deprived applicants.

Deliberations and Recommendations
The Committee deliberated over several sittings over a period of six months. The Committee invited relevant parties and experts from various organizations to update itself about facts and to take inputs on the various options available to fulfill the task. Based upon these deliberations and inputs received, The Committee makes these recommendations:

- All these afferent applications were made in the retail category of IPOs. To the extent these fictitious “afferent applicants” were allotted shares, genuine investors were deprived of their chance to secure allotment.

- It may not be possible to get the requisite number of shares from the market or available funds may not be sufficient to purchase the requisite number of shares at the current market price.

- The reallocation should therefore be quantified in monetary terms and the reallocation value for each “deprived applicant” should be initially computed based upon shares but subsequently converted into the amount of gains associated with such shares.

- The Committee recommends that for the purpose of reallocation or payment to these deprived applicants, the amount which is the difference of closing price of shares on the first day of listing / trading at NSE and the IPO issue price will be considered.
• All genuine applicants, whether successful or not, were deprived to some extent.
• On the question of reallocation of shares, the Committee recommends a “spillover” method of reallocation. Under this method, totally unsuccessful applicants shall be reallocated shares equally from the afferent pool, till they each receive the minimum shares allotted to the lowest category in the IPO.
• The Committee has also made certain operational suggestions in the body of the report to facilitate an efficient implementation.

Rebound in Indian Capital Market
The factors that are responsible for rebound phenomenon in Indian Capital Market are as follows:
• Strong macro-economic aggregates.
• Active participation of retail investors with renewed vigor.
• Active FII buying.
• Active III (Indian Institutional Investor) buying.
• Favorable sovereign rating by leading credit rating agencies like S&P, Moody’s, etc.
• Strong foreign exchange reserve position.
• Strong fundamentals of basic and other industrial segments such as steel, FMCGs etc.
• Favorable monsoons fuelling adequate demand for goods and services in the economy.
• Favorable political conditions.
• Forecasts of better prospects in future.

CONCLUSION
Although 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 favorable 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, 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. In spite of the fact that the Indian Capital Market has made a marvelous dent both in primary as well as secondary markets, there are very many issues, which require immediate and urgent attention of the planners concerned.

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