Role of Capital Market in India: A Theoretical View

[a]S. K. Rastogi , [b] Prince Kumar
[a] Associate Professor, Department of Commerce, Hindu College, Moradabad 244001 (UP) Indai
[b] Research Scholar, Department of Commerce, Hindu College, Moradabad 244001 (UP) India

Abstract

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. In this paper I have discussed the conceptual framework of the capital market; trends in the capital market in India; and various issues and challenges of the capital market in India.

KEYWORDS: Capital Market, Role of CM in Economy, Trend & Growth of Capital Market, and Challenges

I. Introduction

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: **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; and **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.

II. Role of Capital Market

It provides an important alternative source of long-term finance for long-term productive investments. This helps in diffusing stresses on the banking system by matching long-term investments with long-term capital. Capital Market provides equity capital and infrastructure development capital that has strong socio-economic benefits - roads, water and sewer systems, housing, energy, telecommunications, public transport, etc. - ideal for financing through capital markets via long dated bonds and asset backed securities. It provides avenues for investment opportunities that encourage a thrift culture critical in increasing domestic savings and investment ratios that are essential for rapid industrialization. It encourages broader ownership of productive assets by small savers to enable them benefit from India's economic growth and wealth distribution. Equitable distribution of wealth is a key indicator of poverty reduction. It promotes 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 inevitable as resources continue to diminish. Capital Market assists the Government to close resource gap, and complement its effort in financing essential socioeconomic development, through raising long-term project based capital. It improves the efficiency of capital allocation through competitive pricing mechanism for better utilization of scarce resources for increased economic growth. It is a gateway to India for global and foreign portfolio investors, which is a need of today.

III. Review of Literature

- **Shenoy, S. S. and Dr. Hebbar, C. K. (2015),** made it clear that India being an emerging economy need more innovations and reforms in the capital 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. However this may entail huge investment in IT infrastructure. Economic growth needs sound financial system which further requires a well-developed capital market. Emerging economies like India need to further sustain the reforms that have been initiated, remove bottlenecks, educate investors, provide investor protection, bring in more transparency in operations and refine policies to increase the depth and reach of the capital market and to make it as competitive as the world's best stock markets.
- **Sam & Salami, K. (2014),** elucidated that there was positive significant effect of capital market development (MKT) and FDI on GDP growth. However, GFI, T-Bills, and INF met their expected signs, but they had insignificant effects on GDP growth. There was also a bi-directional relationship between GDP growth and capital market development. However, the direction of causality is stronger from capital market development to economic growth. This supports the supply-leading hypothesis view of financial development which states that economic growth and development spring from availability of credit facilities from surplus spending units to deficit spending units in an economy.
- **Anju Bala (2013)** explained in her article that Stock Market was the mitigation of risk through the spreading of investments across multiple entities, which was achieved by the pooling of a number of small investments into a large bucket. Stock Market was the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed portfolio at a relatively low cost.
- **Juhi Ahuja (2012)** presents a review of Indian Capital Market & its structure. In last decade or so, it has been observed that there has been a paradigm shift in Indian capital market. The application of many reforms & developments in Indian capital market has made the Indian capital market comparable with the international capital markets. Now, the market features a developed regulatory mechanism and a modern market infrastructure with growing market capitalization, market liquidity, and mobilization of resources. The emergence of Private Corporate Debt market is also a good innovation replacing the banking mode of corporate finance. However, the market has witnessed its worst time with the recent global financial crisis that originated from the US sub-prime mortgage market and spread over to the entire world as a contagion. The capital market of India delivered a sluggish performance.
- **Nath and Verma (2003)** studied the transmission of market movements among the three major stock markets in the Asian region, namely, India, Singapore, and Taiwan. The results proved that there was no long-term interrelationship, and thus, international investors could achieve long-term

gains by investing in the stock markets because of the independencies of the stock markets.

- **Gupta, L. C. (1992)** revealed the findings of his study that there is existence of wild speculation in the Indian stock market. The over speculative character of the Indian stock market is reflected in extremely high concentration of the market activity in a handful of shares to the neglect of the remaining shares and absolutely high trading velocities of the speculative counters. He opined that, short- term speculation, if excessive, could lead to "artificial price". An artificial price is one which is not justified by prospective earnings, dividends, financial strength and assets or which is brought about by speculators through rumours, manipulations, etc. He concluded that such artificial prices are bound to crash sometime or other as history has repeated and proved.

IV. Objective of the Study

- To study the meaning of capital market;
- To explain the role of Capital Market in the developing economy like India;
- To examine the trends established in Indian Capital market; and
- To through light on the emerging issues before Indian Capital Market.

V. Trends in Capital Market in India

5.1 Performance of Primary Market: Primary market assists 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 public as a predecessor to the trading in secondary market of an exchange. Rights Issue is another mode of fund raising. In Right Issue securities are exclusively offered to the existing shareholders of company. 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 or Private Placement. Following Table No. 1 exhibits the resources mobilisation by Corporate Sector and Government through Primary Market in the last decade.

Table No. 1

Resource Mobilization through Primary Market

YEAR	DEBT		EQUITY		PRIVATE PLACEMENT		Total
		%		%		%	
2007-08	1603	0.9	54511	31.2	118485	67.9	174599
2008-09	1500	0.8	2082	1.2	173281	98.0	176863
2009-10	2500	0.9	55055	20.4	212635	78.7	270190
2010-11	9451	3.3	58157	20.3	218785	76.4	286393
2011-12	35611	11.5	12857	4.2	261283	84.4	309751
2012-13	16982	4.3	15473	3.9	361462	91.8	393917
2013-14	42383	12.8	13269	4.0	276054	83.2	331706
2014-15	9413	2.2	9789	2.3	404137	95.5	423339
2015-16	33812	6.6	24054	4.7	458073	88.8	515939
2016-17	29547	4.2	32520	4.6	640716	91.2	702783

(Source: SEBI)

The Indian capital primary market showed a trend of fund raising through Private Placement. The heat of the financial crisis 2008 was also felt in the Primary Capital Market when companies put public offer on hold and preferred private placement as important source of funds mobilization which accounted for about 95% of the total funds. In the last decade resources mobilised with the help of IPO are less than 5% each year except 2007-08, 2009-10 and 2010-11. Funds rose with the help of debts instruments like NCD, PCD and Bonds etc were also less than 5% except 2011-12, 2013-14 and 2015-16. **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 86%.**

5.2 Performance of Mutual Fund: The Mutual Fund history provides ample evidence that Indian financial institutions have played a dominant role in asset formation and intermediation, and contributed substantially to the process of macro-economic development. Mutual funds, which have emerged as strong financial intermediaries, are playing an important role in this process. They are not only providing stability to the financial system, but have also helped rationalize the process of resource allocation. They have opened new vistas for investors and increase the level of liquidity in the system. In the process, they have challenged the hitherto dominant role of the commercial banks.

The Indian Mutual Fund industry consists of 42 players. Table No. 2 clears that throughout the period from 2007-08 to 2016-17 the Debt oriented schemes have been shown greater confidence as compare to Equity scheme by the investors in India. Also, the amount invested in the debt oriented scheme has mostly increased except 2008-09, 2010-11 and 2011-12.

In the last three year of study, since the stable government formed in the leadership of Sri Narendra Modiji, resources mobilised by Mutual Funds in equity scheme has been gone up rapidly. It shows investor confidence in the government policies.

Table No. 2

Resource Mobilisation and Assets under Management by Mutual Funds

YEAR	**DEBTS SCHEME**				**EQUITY SCHEME**			
	Sale	Redemption	Net	AUM	Sale	Redemption	Net	AUM
2007-08	4317263	4213396	103867	312997	147113	97179	49934	192155
2008-09	5383367	5415528	-32161	294349	42986	39122	3864	122951
2009-10	9944693	9863485	81208	393204	74329	72458	1871	220776
2010-11	8777034	8817377	-40343	369049	82481	91543	-9062	223200
2011-12	6754113	6779766	-25653	374857	65566	61936	3630	212360
2012-13	7213578	7123396	90182	497451	54307	67950	-13643	203992
2013-14	9709762	9646422	63340	600945	58338	67896	-9558	224295
2014-15	10912088	10889532	22556	694128	174171	93440	80731	388629
2015-	135515	13518545	33008	78290	21400	112830	10117	44992

16	53			0	2		2	4
2016- 17	173036 10	17090456	21315 4	10746 52	31193 9	182044	12989 5	67996 7

(Source: SEBI)

5.3 Investment by FIIs in Indian Capital Market: The foreign institutional investors have always preferred investment in emerging equity market, but they were net seller in all market when there are any crises in the market or economy, Indian Capital Market is not an exception in their views. As we can see in the following Table No. 3 that in 2008-09 and 2015-16, FIIs were net seller in Indian Capital Market as there was recession in 2008-09 and 2015-16, otherwise FIIs were net buyer in Indian Market.

Table No. 3

Investment by FIIs in Indian Capital Market

YEAR	Gross Purchase	Gross Sales	Net Investment
2007-08	948018	881839	66179
2008-09	614576	660386	-45810
2009-10	846438	703780	142658
2010-11	992599	846161	146438
2011-12	921285	827562	93723
2012-13	904845	736481	168364
2013-14	1021021	969321	51700
2014-15	1521346	1243886	277460
2015-16	1324418	1342593	-18175
2016-17	1507028	1458617	48411

(Source: SEBI)

VI. Performance of Secondary Market: Performance of Secondary Market of Indian Capital Market is classified into following categories:

6.1. Movement of Index: Sensex and Nifty are one of the barometer of Indian Economy's feel-good factor was at 21,000 marks prior to Global Financial Crisis followed Great recession worldwide. However, in recent years both the index witnessed volatile but consolidation trends due to global and domestic factors. Following Table No. 4 showed the trends of SENSEX and NIFTY of the last ten years. It is cleared from the table that SENSEX and NIFTY both showed long tern north way movement with volatile trends in some years such as 2008-09, 2011-12 and 2015-16.

Table No. 4

Index Movement

YEAR	Index			
	SENSEX	% Change	NIFTY	% Change
2007-08	**15644**		**4735**	
2008-09	**9709**	**-37.9**	**3029**	**-36.2**
2009-10	**17528**	**80.5**	**5249**	**73.8**
2010-11	**19445**	**10.9**	**5834**	**11.1**
2011-12	**17404**	**-10.5**	**5296**	**-9.2**
2012-13	**18836**	**8.2**	**5683**	**7.3**

2013-14	**22386**	**18.8**	**6704**	**18.0**
2014-15	**27957**	**24.9**	**8491**	**26.7**
2015-16	**25342**	**-9.4**	**7738**	**-8.9**
2016-17	**29621**	**16.9**	**9174**	**18.5**

(Source: SEBI)

6.2 Market capitalization and P/E Ratio: Market capitalization is the total value of a company's outstanding shares. The BSE shows increasing trend of market capitalization except the year 2008-09, 2011-12 and 2015-16 in which economy was in recession. P/E ratio is the valuation ratio of a company's current share price compared to its per share earnings. P/E ratio showed declining trend except 2009-10 till 2012-13 than after it increased year on year basis.

Table No. 5

Trend of Market Capitalization and P/E Ratio

(Rs. in Crore)

YEAR	**BSE**				**NSE**			
	Market Capitalisation		**P/E Ratio**		**Market Capitalisation**		**P/E Ratio**	
	Amount	**% Change**	**Ratio**	**% Change**	**Amount**	**% Change**	**Ratio**	**% Change**
2007-08	5138014	**---**	20.1	**---**	4858122	**---**	20.6	**---**
2008-09	3086075	**-39.9**	13.7	**-31.8**	2896194	**-40.4**	14.3	**-30.6**
2009-10	6165619	**99.8**	21.3	**55.5**	6009173	**107.5**	22.3	**55.9**
2010-11	6839083	**10.9**	21.2	**-0.5**	6702616	**11.5**	22.1	**-0.9**
2011-12	6214941	**-9.1**	17.8	**-16.0**	6096518	**-9.0**	18.7	**-15.4**
2012-13	6387887	**2.8**	16.9	**-5.1**	6239035	**2.3**	17.6	**-5.9**
2013-14	7415296	**16.1**	18.3	**8.3**	7277120	**16.6**	18.9	**7.4**
2014-15	10149290	**36.9**	19.5	**6.6**	9930122	**36.5**	22.7	**20.1**
2015-16	9475328	**-6.6**	19.3	**-1.0**	9310471	**-6.2**	20.9	**-7.9**
2016-17	12154525	**28.3**	22.6	**17.1**	11978421	**28.7**	23.3	**11.5**

(Source: SEBI)

Table No. 5 also exhibits that the NSE shows similar trends both in Market Capitalisation as well as P/E Ratio.

6.3 Turnover of Equity and Derivative Segment in Capital Market:

The NSE shows increasing trend of quantity of shares delivered where as BSE shows fluctuating trend throughout the period of 2007-08 to 2016-17. Following Table No. 6

represented the data of turnover of Cash and Derivative Segment of both the major exchange (BSE and NSE) of Indian Capital Market.

In Cash Segment the BSE the oldest exchange of India is losing its sheen year on year basis in comparison to NSE. As the cash turnover of BSE has decreased to Rs. 998261 cr. in 2017-18 from Rs 1578857 cr. in 2007-08. It was further slipped in 2013-14 to a low of Rs. 521664 cr., on the other hand turnover of cash segment of NSE has increased from Rs. 3551038 cr. in 2007-08 to Rs. 5055913 cr. in 2016-17.

A derivative is a security whose price is dependent upon or derived from one or more underlying assets. Its value is determined by fluctuations in underlying asset. Investors can use equity derivatives to hedge the risk associated with taking a position in stock by setting limits to the losses incurred by either a short or long position in a company's share. The NSE shows increasing trend in trading of equity derivatives throughout the period from 2007-08 to 2016-17. Turnover of NSE has increased seven fold during the same period. On the other side the BSE shows fluctuating trend for the same. Turnover of BSE was negligible and highly volatile during the period of study. It shows that NSE, stock exchange with difference, has investors and intermediaries friendly rules and regulation with strict parameters. Similar in the case of derivative segment,

Table No. 6
Turnover of BSE and NSE (Cash and Derivative Segment of Equity)
(Rs. in Crore)

YEAR	Stock Exchange							
	BSE				NSE			
	Cash	% Change	Derivative	% Change	Cash	% Change	Derivative	% Change
2007-08	1578857	--	242309	--	3551038	--	13090478	--
2008-09	1100075	-30.3	11775	-95.1	2752023	-22.50	11010482	-15.89
2009-10	1378809	25.3	234	-98.0	4138023	50.4	17663665	60.4
2010-11	1105027	-19.9	154	-34.1	3577410	-13.5	29248221	65.6
2011-12	667498	-25.6	808476	524884.4	2810892	-21.4	31349732	7.2
2012-13	548774	-6.4	7163519	786.1	2708279	-3.7	31533004	0.6
2013-14	521664	-4.9	9219434	28.7	2808488	3.7	38211408	21.2
2014-15	854845	63.9	20362741	120.9	4329655	54.2	55606453	45.5
2015-16	740089	-13.4	4475008	-78.0	4236983	2.1	64825834	16.6
2016-17	998261	34.9	6939	-99.8	5055913	19.3	94370302	45.6

(Source: SEBI)

VII. Issues and Challenges of Indian Capital Market: Globalisation and Liberalisation will result in competition and greater efficiency in Capital Market. But, increased foreign participation will bring additional risk and exposure. To protect local and small investor in financial markets, safeguarding mechanism need to be improved. The equity market in India is extremely energetic and vibrant. But for the rapid growth of a country developed debt market is equally responsible. Although some efforts has been done in this line, but emphasis should be given to develop debt market in India. To make Indian capital market as compared to other markets such as US, China, UK, Germany etc. Following measures should be considered:

1. Knowledge based programme should be held for small and medium investors' education as only 3% Indian peoples invest in Stocks;
2. Mutual Fund should be given more and more emphasis, because they can pool small investors in the main line of investment;
3. Allowing AMCs to the flexibility to charge fees with capping maximum limit;
4. Income Tax relaxation on debt instruments so that debt market may develop in the country;
5. Amending tax regime to encourage domestic AMCs to manage foreign funds from India
6. Insurance companies and pension funds should be allowed to invest in capital markets to provide better return to their investors;
7. Allowing institutional investors to participate in commodity markets; and
8. Transparency in Government Schemes, so that, confidence of local investors as well as foreign investors may further increased in Indian Capital Market.

VIII. Conclusion: India, one of the fastest developing countries, an emerging economy needs innovations and reforms in the financial market. Undoubtedly that there is a positive correlation between the finance and the economic growth of the country, but economic growth needs sound financial system which further requires the well developed financial market. Large projects of infrastructure, such as road, rail and urban and rural sanitisation, are to be implemented, which requires huge funds. It is a good sign that Indian Capital Market (equity) is on the path of success. Innovation and reforms are required to develop its capital market especially its debt segment which is underdeveloped because of policies constraint. As it 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. 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.

REFERENCES

- **Articles:**
- Shenoy, S. S. and Dr. Hebbar, C. K. (2015), A Comparative Study of Stock Market Reforms in India and Select Countries Abroad, Proceedings of International Conference on Management Finance Economics, July 11-12, 2015, ISBN:9788193137307

- Sam & Salami, K., ‘Effect of Capital Market Development on Economic Growth in Ghana’, European Scientific Journal, Edition: March 2014, Vol.10, No.7 ISSN: 1857 – 7881 (Print) e - ISSN 1857- 7431
- Anju bala (2013), Indian Stock Market - Review of Literature, TRANS Asian Journal of Marketing & Management Research Vol.2 Issue 7, July 2013, ISSN 2279-0667
- Juhi Ahuja (2012), “Indian Capital Market: An Overview with Its Growth” VSRD International Journal of Business & Management Research Vol. 2 (7), pp. 386-399.
- Nath, G. C., Verma, S. (2003). Study of common stochastic trend and co-integration in the emerging markets: A case study of India, Singapore and Taiwan (NSE Research Paper No.72). Mumbai, India: National Stock Exchange.
- Gupta, L.C. (1992), "Stock Trading in India", Society for Capital Market Research and Development, Delhi.

b. Annual Reports

- Annual Reports of SEBI from 2007-08 to 2016-17
- Annual reports of BSE from 2007-08 to 2016-17
- Annual reports of NSE from 2007-08 to 2016-17

c. Books

- Kothari and Garg, (2016), ‘Research Methodology: Method and Techniques’, New Age International Publishers, New Delhi, 3rd Ed.
- Avadhani, V.A. (2011), ‘Capital Market Management’, Himalaya Publishing House, New Delhi, 4th Ed.

d. Websites

- www.sebi.gov.in
- www.nseindia.com
- www.bseindia.com
- www.rbi.org.in