

## **Role of Capital Market in the Economic Development of India**

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### **ABSTRACT**

The capital market in India has made enormous progress in developing sophisticated instruments and modern market mechanisms. The key strengths of the Indian capital market include a fully automated trading system on all stock exchanges, a wide range of products, and an integrated platform for trading in both cash and derivatives. The capital market constitutes a vital segment of the Indian economy, along with the financial institutions that finance the economic development of the country. Stock market development like the economic development is a complex and multifaceted concept and no single measure will capture all views of stock market growth. It thus necessitates the study of a wide array of stock market growth indicators like stock market size, market liquidity, and regulatory and institutional growth. In the light of the above, it can be said that an investor is never determined in his power to exploit the opportunities available in the economy, which mobilizes and saves so as to enhance the wealth of the investors. This study evaluates capital market and developing economies, challenges to capital market growth, and economic growth in India and policy directions for promoting capital market growth in developing countries.

**Keywords:** capital market, economic growth, economic development

### **1. INTRODUCTION**

The trading in the capital market became much easier and faster than what it was earlier with the improvement in the technology. In the initial stages, the trading in the capital market was restricted to a few players. Further, the number of participants increased steadily with increasing importance of the market for the nation. But to start with, trading on stock exchanges in India used to take place through open outcry without the use of any kind of technology<sup>49</sup>. There was no immediate matching of orders or records of trades. The trading was time consuming and inefficient. The practice of physical trading imposed limits on trading volumes. Stimulating economic growth and development requires long term funding, far longer than the duration for which most savers are willing to commit their funds and this constitutes a barrier to economic growth. In this regard, the capital market provides an avenue for the mobilization and utilization of long-term funds for development and hence it is referred to as the long term end of the financial system. Financial markets in India comprise the money market Government securities market, capital market, insurance market, and the foreign exchange market. Recently, the derivatives market has also emerged. With banks having already been allowed to undertake insurance business, bane assurance market has also emerged in a big way. Till the early 1990s most of the financial markets were characterized by controls over the pricing of financial assets, restrictions on flows or transactions, barrier to entry, low liquidity and high transaction costs. These characteristics came in the way of development of the markets and allocate efficiently of resources channeled through them. From 1991 onward, financial market reforms have

emphasized the strengthening of the price discovery process easing restrictions on transactions, reducing transaction costs and enhancing systemic liquidity.

## **2. REVIEW OF LITERATURE**

Wagner and Berger (2004) and Calvo et al. (1996) argue that sudden capital stops is the main reason behind recent crises which means that growth advantages due to greater inflows of foreign capital were greatly diminished. According to Garcia and Liu (1999) a stable macroeconomic environment is crucial for the development of the capital market. Macroeconomic volatility worsens the problem of informational asymmetries and becomes a source of vulnerability to the financial system. Garcia and Liu (1999) argued further that sound macroeconomic environments and sufficiently high income levels; GDP per capita, domestic savings, and domestic investments are important determinants of stock market development in emerging markets. Yartey (2007) notes that the development of the banking sector is important for stock market development in developing economies. Demirguc-Kunt and Levine (1996) found that most capital market indicators are highly correlated with banking sector development. Countries with well-developed stock markets tend to have well developed financial intermediaries.

## **CHALLENGES OF INDIA CAPITAL MARKET**

- Small size of the market
- Slow growth of securities market
- Lack of knowledge in securities market
- Problem of macroeconomic instability
- Double taxation

## **3. IMPORTANCE OF THE STUDY**

The Indian capital market has witnessed a major transformation and structural reforms in the wake of liberalization and globalization. The financial sector reforms attracted the academicians, researchers and practitioners to learn more about capital markets operations and their implications. The initiatives taken by the regulatory authority mainly emphasized on the objectives such as improving market efficiency, enhancing transparency, checking unfair trade practices, and bringing the Indian capital market up to international standards. As a result of these reforms, numerous changes have been inculcated in the operations of the secondary markets such as automated online trading, reduction in the settlement period and providing more opportunities for foreign portfolio investors and the like. In addition to these developments, the Indian market is being considered to be one of the emerging markets in the world, which has introduced derivative products in line with the other developed counterparts, facilitating risk management to investors.

Resource Mobilisation via SME Platform SEBI permitted the setting up of a separate dedicated platform for the listing and trading of SME securities in last financial year (2012-13). The SME platform of the exchange is intended for small and medium sized companies with high growth potential, whose post issue paid up capital shall be less than or equal to Rs.25 crore. Sector

wise resource mobilize were analyze through percentages value which were collected from SEBI annual report

**SECTOR WISE RESOURCE MOBILIZATION**

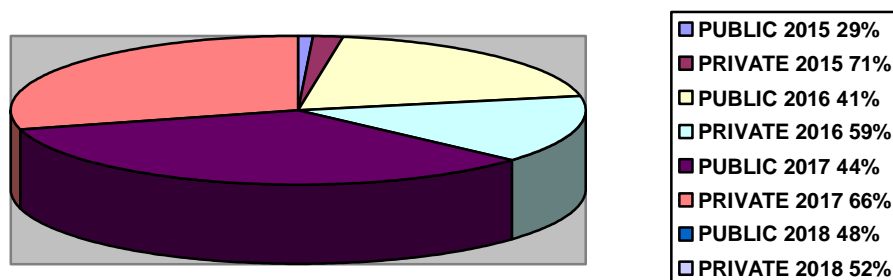
SECTORS	2015	2016	2017	2018
PERCENTAGE SHARE IN THE TOTAL AMOUNT	PERCENTAGE SHARE IN THE TOTAL AMOUNT	PERCENTAGE SHARE IN THE TOTAL AMOUNT	PERCENTAGE SHARE IN THE TOTAL AMOUNT	PERCENTAGE SHARE IN THE TOTAL AMOUNT
Private	71	59	66	52
Public	29	41	44	48
Total	100	100	100	100

The percentage values are collected from SEBI annual report

**TABLE NO 1**

**SECTORAL SHARES IN THE TOTAL RESOURCE ALLOCATION**

**SECTOR WISE ALLOCATION**



**FIG 1**

The amount raised through public sector issues was 48% percent of the total resource mobilization. This is the fourth consecutive financial year wherein the public sector issues garnered a larger share of the resource mobilization in the primary market compared to 2015 to 2017

**CAPITAL MARKET DEVELOPMENTS**

SINCE 1991 with the implementation of New Economic Policy drastic changes occurred in Indian capital market<sup>18</sup>. Some of the important measures are a) 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

- **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.

- **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.
- **Dematerialisation Of Shares (Demat)**: Demat 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.
- **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.
- **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.
- **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.
- **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 (FIIs), 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.

- **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.

## **COMPONENTS OF THE CAPITAL MARKET**

The capital markets are broadly classified into debt and equity markets. Debt markets are characterized by large institutional involvement with less presence of retail participation. Debt markets involve in the trade of government securities, treasury bills, corporate bonds, other debt instruments while equity markets deal mainly in equity shares and to a limited extent in preference shares and company debentures<sup>1</sup>. Recently, futures and options in indices and equity shares have also become a part of the market. In the context of equity product, the markets are classified into- Primary market and Secondary market. Of late, derivatives market has also become a part of the broader market. In the capital markets, there is large number of participants with variety of products. The various components of capital market are as follows:-

- **Market regulators:** - The regulators in the capital markets are SEBI, RBI (to some extent), Department of Company Affairs, and Department of Economic Affairs of the Central government.
- **Segments of capital market:** There are two interdependent and inseparable segments in the Indian capital market. These segments are the primary market and stock (secondary) market.
- **Securities:** - The term securities include shares, bonds, debentures, futures, options, mutual funds units  
**Intermediaries:** - Intermediaries include brokers, sub-brokers, custodians, share transfer agents, merchant bankers, and depositories.
- **Issuers of securities:-** Companies, body corporate, banks, government, financial institutions, mutual funds
- **Investors:-** Investors include individuals, companies, mutual funds, financial institutions, foreign institutional investors

## **PRIMARY MARKET**

For sale of new securities the primary market provides the channel. The issuer of securities sells the securities in the primary market to raise funds for investment and/ or to discharge. In other words, the market wherein resources are mobilized by entities through issue of new securities is called the primary market. These resources are required for new projects as well as for existing projects with a view to expansion, diversification, and modernization and up gradation. The issue of securities by companies can take place in any of the following methods:-

- Initial public offer (securities issued for the first time to the public by the company);
- Further issue of capital;
- Rights issue to the existing shareholder (on their renunciation, the shares can be sold by the company to others also);
- Bonus Issue
- Offer to public
- Offer of securities under reservation/ firm allotment basis to; Foreign partners and collaborators, Mutual funds Merchant bankers Banks and institutions Non resident Indians and overseas corporate bodies Employees.

To the economy of a country the primary market is of great significance. It is through the primary market that funds flow for productive purposes from investors to entrepreneurs. The latter use the funds for creating new products and rendering services to customers in India and abroad. The strength of the economy of a country is gauged by the activities of the Stock exchanges. The primary market creates and offers the merchandise for the Secondary Market.

## **SECONDARY MARKET**

Secondary market refers to a market where securities are traded after being initially offered to the public in the primary market and/or listed on the Stock Exchange. Majority of the trading is done in the secondary market. Secondary market comprises of equity markets and the debt markets. The secondary market enables participants who hold securities to adjust their holdings in response to changes in their measurement of risk and return. They also sell securities for cash to meet their liquidity needs. The secondary market has supplementary two components, namely the over-the-counter (OTC) market and the exchange- traded market. OTC is different from the market place provided by the Over The Counter Exchange of India Limited. OTC markets are fundamentally informal markets where trades are negotiated. Most of the trades in government securities are in the OTC market. All the spot trades where securities are traded for immediate delivery and payment take place in the OTC market. The exchanges do not make available facility for spot trades in a strict sense . A variant of secondary market is the forward market, where securities are traded for future delivery and payment. Pure forward is outside the formal market. The versions of forward in formal market are futures and options. In futures market, standardized securities are traded for future delivery and settlement. These futures can be on a basket of securities like an index or an individual security. In case of options, securities are traded for conditional future delivery. There are two types of options—a put option permits the owner to sell a security to the writer of options at a predetermined price while a call option permits the owner to purchase a security from the writer of the option at a predetermined price.

## **FACTORS RESPONSIBLE FOR GROWTH AND DEVELOPMENT OF CAPITAL MARKET**

- **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.
- **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 Underwriting Business:** The growing underwriting business has contributed significantly to the development of capital market.
- **Growth of Multinationals (MNCs):** The MNCs require medium and long term funds for setting up new projects or for expansion and modernization. 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 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.
- **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.
- **Growth of Mutual Funds:** The mutual funds collect 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.
- **Development of Venture Capital Funds:** Venture capital represents financial investment in highly risky projects with a hope of earning high returns after 1991, economic liberalization 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.
- **Increasing Awareness:** During the last few years there has 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

## **POLICY IMPLICATIONS AND RECOMMENDATIONS**

The policy implications of the findings of the study and the conclusion drawn suggest that the role of Capital market can be better harnessed for economic growth and development of the country by promoting. This can be achieved only if there is a large and active investor base. SEBI, NSE, BSE and other several institutions have been conducting training programmes to create a cadre of well trained professionals to undertake the trading and invest, but still most of the traders and investors lack proper understanding of the concepts related to trading. They are trading as speculators where they often lose money than gain. The volumes have definitely increased but due to lack of proper education, awareness and knowledge of the capital market, the desired volumes resulting into profitable activity has yet to happen. It is therefore suggested that training and educational awareness programmes should be conducted in smaller cities to popularize capital market instrument. An aware investor will be better equipped to take risk and benefit from participating in markets. Although the government is spending lot of funds on research in financial markets, but retail investors do not understand complex models that the research talks about. Research in the field of investor education should instead be promoted.

This will also help in increasing the investor base in India which is currently minimal compared to developed countries.

#### **4. CONCLUSION**

The dependence of the economy on banking system for financing capital needs cannot be negated, but the banking system in the country, which is highly regulated, can seldom fulfill the ever growing funding needs of the capital market. Thus the immediate need is to revive the existing sluggish bond market, which is underdeveloped due to policy constraints Indian Industry, since its presence in organized form, has contributed substantially and continuously for the growth of its economy by transforming itself as one of the important sources for economic welfare and prosperity. The industry provides the required resources to its incumbents and creates optimal employable opportunities for its resources (natural, human, technical, financial, etc). The changing nature and structure of business from domestic to transnational has seen a metamorphic change. It has also brought about a synergic growth contributing significantly to its Gross Domestic Product (GDP). The infrastructural requirements of a developing economy like India are high and hence only a deep and innovative bond market would only be able to bridge the gap that exists between the demand and supply. Bottlenecks need to be removed from the bond market so as to allow the bond market to nurture the growth of the equity market and make the bond market competitive in the international bond markets in other developed nations.

#### **FUTURE PROSPECTS**

The present study analyzing a growing segment of Indian capital market in the economic development, with a view to understand the investment activity of the people in the capital market. An attempt has been made to understand the fears and myths of people concerning trading and investment. The study has taken a general view of capital market and gathered information from the brokers and sub-brokers dealing in segment on behalf of their clients. Future studies can be undertaken to address this issue in a wider perspective by directly contacting the retail investor and exploring his views on different instruments being traded in the Indian capital market. There may be factors such as education, income level, profession etc. other than age and risk profile which may cause a major influence on the investor's intention to trade. The growth of financial markets is spearheaded by the retail investors, so it is essential to understand their perception, opinion and behavior to boost up the investment activity.

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