

REFORMS OF CAPITAL MARKET IN INDIA

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Abstract: The significant transformation of the Capital Market in India is clearly evident from the changes that have occurred in the Stock market. The developments have facilitated greater choice for investors, who have become more discerning and demanding.

Currently, the most important factor shaping the world is globalization. The benefits of globalization have been well documented and are being increasingly recognized. Integration of domestic markets with international financial markets has been facilitated by tremendous advancement in information and communications technology. But, such an environment has also meant that a problem in one country can sometimes adversely impact one or more countries instantaneously, even if they are fundamentally strong.

There is a growing realization that the ability of countries to conduct business across national borders and the ability to cope with the possible downside risks would depend on the soundness of the Capital market. This has consequently meant the adoption of a strong and transparent, prudential, regulatory, supervisory, technological and institutional framework in the sector on par with international best practices is necessary. All this necessitates a transformation: a transformation in the mindset, a transformation in the business processes and finally, a transformation in knowledge management.

Keywords: Capital Market, Transparent, Regulatory, Supervisory, Stock Market etc.

OBJECTIVES

1. To study the Capital market reforms –from-1991 to till date in India
2. To know the Factors Responsible for Growth and Development of capital market
3. To suggest Members for future the growth of capital Market in India.

Methodology

- Secondary data: - the sources of secondary data were internet, books and newspaper articles.

I. INTRODUCTION

Capital market refers to the market for long-term funds for investment purposes. The capital market is the source of funds for corporate, governments and provides opportunities to savers to park their long-term savings. The capital market comprises of two segments- the primary and the secondary markets.

Broad term describing any market place where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. Financial Markets are typically defined by having transparent pricing, basic regulations on trading, costs and fees and market forces determining the prices of securities that trade. In economics, typically, the term market means the aggregate of possible buyers and sellers of a certain good or service and the transactions between them. The term "market" is sometimes used for what are more strictly exchanges, organizations that facilitate the trade in financial securities, e.g., a stock exchange or exchange in Finance, Financial Markets facilitate:

1. The raising of capital (in the Capital Markets)
2. The transfer of risk (in the Derivatives Markets)
3. The transfer of liquidity (in the Money Markets)
4. International trade (in the Currency Markets)

II. FACTORS RESPONSIBLE FOR GROWTH AND DEVELOPMENT OF CAPITAL MARKET

- **Growth of Development Banks and Financial Institutions**

For providing long term funds to industry, the government set up Industrial Finance Corporation in India (IFCI) in 1948. This was followed by a number of other development banks and institutions like the Industrial Credit and Investment Corporation of India (ICICI) in 1955, Industrial Development Bank of India (IDBI) in 1964, Industrial Reconstruction Corporation of India (IRCI) in 1971, Foreign Investment Promotion Board in 1991, Over the Counter Exchange of India (OTCEI) in 1992 etc. In 1969, 14 major commercial banks were nationalized. Another 6 banks were nationalized in 1980. These financial institutions and banks have contributed in widening and strengthening of capital market in India.

- **Setting up of SEBI**

The Securities Exchange Board of India (SEBI) was set up in 1988 and was given statutory recognition in 1992.

- **Increasing Awareness**

During the last few years there have been increasing awareness of investment opportunities among the public. Business newspapers and financial journals (The Economic Times, The Financial Express, Business India, and 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.

- **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 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.

III. REFORMS IN CAPITAL MARKET SINCE 1991

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

- **Dematerialization of Shares**

Dematerialization 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 modernized in 90s, with Computerized Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and thereby leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

- **Establishment of 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.

- **Establishment of 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.

- **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 utilized for promotion of awareness amongst investors and protection of their interests.

- **The National Securities Clearing Corporation Limited (NSCL)**

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-empt market failures.

- **Trading In Central Government Securities**

In order to encourage wider participation of all classes of investors, including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driven, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

- **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.

- **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, and 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.

- **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.

- **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.

IV. 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.

- **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.

- **The Clearing Corporation Of India Limited (CCIL)**

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US \$ forex spot and forward deals. All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, while those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

V. RECENT DEVELOPMENTS IN CAPITAL MARKET OF INDIA

The Indian capital market has witnessed major reforms in the decade of 1990s and there after. It is on the verge of the growth.

Thus, the Government of India and SEBI has taken a number of measures in order to improve the working of the Indian stock exchanges and to make it more progressive and vibrant.

Reforms in Capital Market of India

The **major** reforms undertaken in capital market of India includes:-

1. Establishment of SEBI

The Securities and Exchange Board of India (SEBI) was established in 1988. It got a legal status in 1992. SEBI was primarily set up to regulate the activities of the merchant banks, to control the operations of mutual funds, to work as a promoter of the stock exchange activities and to act as a regulatory authority of new issue activities of companies. The SEBI was set up with the fundamental objective, "*to protect the interest of investors in securities market and for matters connected therewith or incidental thereto.*"

The main functions of SEBI are:-

- I. To regulate the business of the stock market and other securities market.
- II. To promote and regulate the self regulatory organizations.
- III. To prohibit fraudulent and unfair trade practices in securities market.
- IV. To promote awareness among investors and training of intermediaries about safety of market.
- V. To prohibit insider trading in securities market.
- VI. To regulate huge acquisition of shares and takeover of companies.

2. Establishment of Creditors Rating Agencies

Three creditors rating agencies viz. The Credit Rating Information Services of India Limited (CRISIL - 1988), the Investment Information and Credit Rating Agency of India Limited (ICRA - 1991) and Credit Analysis and Research Limited (CARE) were set up in order to assess the financial health of different financial institutions and agencies related to the stock market activities. It is a guide for the investors also in evaluating the risk of their investments.

3. Increasing of Merchant Banking Activities

Many Indian and foreign commercial banks have set up their merchant banking divisions in the last few years. These divisions provide financial services such as underwriting facilities, issue organizing, consultancy services, etc. It has proved as a helping hand to factors related to the capital market.

4. Candid Performance of Indian Economy

In the last few years, Indian economy is growing at a good speed. It has attracted a huge inflow of Foreign Institutional Investments (FII). The massive entry of FIIs in the Indian capital market has given good appreciation for the Indian investors in recent times. Similarly many new companies are emerging on the horizon of the Indian capital market to raise capital for their expansions

5. Rising Electronic Transactions

Due to technological development in the last few years. The physical transaction with more paper work is reduced. Now paperless transactions are increasing at a rapid rate. It saves money, time and energy of investors. Thus it has made investing safer and hassle free encouraging more people to join the capital market.

6. Growing Mutual Fund Industry

The growing of mutual funds in India has certainly helped the capital market to grow. Public sector banks, foreign banks, financial institutions and joint mutual funds between the Indian and foreign firms have launched many new funds. A big diversification in terms of schemes, maturity, etc. has taken place in mutual funds in India. It has given a wide choice for the common investors to enter the capital market.

7. Growing Stock Exchanges

The numbers of various Stock Exchanges in India are increasing. Initially the **BSE** was the main exchange, but now after the setting up of the **NSE** and the **OTCEI**, stock exchanges have spread across the country. Recently a new Inter-connected Stock Exchange of India has joined the existing stock exchanges.

8. Investor's Protection

Under the purview of the SEBI the Central Government of India has set up the Investors Education and Protection Fund (IEPF) in 2001. It works in educating and guiding investors. It tries to protect the interest of the small investors from frauds and malpractices in the capital market.

9. Growth of Derivative Transactions

Since June 2000, the NSE has introduced the derivatives trading in the equities. In November 2001 it also introduced the future and options transactions. These innovative products have given variety for the investment leading to the expansion of the capital market.

10. Insurance Sector Reforms

Indian insurance sector has also witnessed massive reforms in last few years. The Insurance Regulatory and Development Authority (IRDA) was set up in 2000. It paved the entry of the private insurance firms in India. As many insurance companies invest their money in the capital market, it has expanded.

11. Commodity Trading

Along with the trading of ordinary securities, the trading in commodities is also recently encouraged. The Multi Commodity Exchange (MCX) is set up. The volume of such transactions is growing at a splendid rate.

VI. REBOUND IN INDIAN CAPITAL MARKET

The factors that are responsible for rebound phenomenon in Indian Capital Market are as follows:

- Active FII buying.
- Active III (Indian Institutional Investor) buying.
- Favourable sovereign rating by leading credit rating agencies like S&P, Moody's, etc.
- Favourable monsoons fuelling adequate demand for goods and services in the economy.
- Favourable political conditions.
- Strong foreign exchange reserve position.
- Strong fundamentals of basic and other industrial segments such as steel, FMCGs etc.
- Forecasts of better prospects in future.
- Strong macro-economic aggregates.
- Active participation of retail investors with renewed vigor.

VII. SUGGESTION

1. Managing Investment of growing balances for which development of financial and capital market and greater attention to corporate governance will be necessary.
2. Achieving transparency and accountability.
3. Giving higher priority to fiduciary responsibility.
4. Reducing administrative costs, and investment management fees and charges.

VIII. CONCLUSION

Capital market is playing its important role in the development of Indian economy. 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 favourable 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, it is important to note that 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. There are very many issues, which require immediate and urgent attention of the planners concerned.

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