ISBN: 978-93-90847-81-5

7. Emerging Trends in Indian Capital Market

Rohit Kumar M.

Assistant Professor,
Department of Business Management,
Lal Bahadur College,
Warangal, Telangana.

7.1 Introduction:

Capital market is a place where buyers and sellers engage in trade of financial securities. Buying/selling can be undertaken by both individuals and institutions. Capital markets will facilitate channelize surplus funds from savers to institutions. It also helps in investing them into productive use. Capital market consists of primary markets and secondary markets. Primary markets deal with trade of new issues of stocks and other securities, whereas secondary market deals with the exchange of existing or previously-issued securities. Another important division in the capital market is made on the basis of the nature of security traded, i.e. stock market and bond market.

The primary market deals with the issuance of new securities. Companies' governments or public sector institutions can obtain funding through the sale of a new stock or bond issue. This is typically done through a syndicate of securities dealers. The process of selling new issues to investors is called underwriting. In the case of a new stock issue this sale is an initial public offering (IPO). Dealers earn a commission that is built into the price of the security offering; through it can be found in the prospectus. In simple word The Primary Market is where financial instruments are sold from the issuer to investors.

The secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. Alternatively secondary market can refer to the market for any kind of used goods. The market that exists in a new security just after the new issue is often referred to as the aftermarket. Once a newly issued stock is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market markers provide bids and offers in the new stock. The financial instruments used in capital markets include stocks and bonds, but the instruments used in the money markets include deposits, collateral loans, acceptances and bills of exchange. Institutions operating in money markets are central banks, commercial banks and acceptance houses, among others.

There are a number of capital market instruments used for market trade, including, stocks, bonds, debentures, treasury-bills, foreign exchange, fixed deposits, and others.

7.2 Functions of Capital Market:

Facilitates the link between Savers and Investors: The capital market functions as a link between savers and investors. It plays an important role in mobilizing the savings and diverting them in productive investment.

Encouragement to saving: with the development of capital, market, the banking and non-banking institutions provide facilities, which encourage people to save more.

Encouragement to Investment: The capital market facilitates lending to the businessmen and the government and thus encourages investment. It provides facilities through banks and nonbank financial institutions. Various financial assets, e.g., shares, securities, bonds, etc., induce savers to lend to the government or invest in industry.

Promotes Economic Growth: The capital market not only reflects the general condition of the economy, but also smoothens and accelerates the process of economic growth. Various institutions of the capital market, like nonbank financial intermediaries, allocate the resources rationally in accordance with the development needs of the country.

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

7.3 Recent Changes in Indian Capital Market:

After the nationalization of commercial banks, there has been a steady growth in both agriculture and industrial finance. Certain new financial institutions have been created in the country such as NABARD, EXIM Bank, SIDBI, etc., which were responsible for providing funds to the capital market. In the existing development banks, certain operational changes were made, which enabled them to finance more industrial activity in the country.

Mutual funds started in both public and private sector banks have also improved the working of capital market in India. Following changes in Indian capital market that had helped India to compete with developed countries around the world.

Economic Liberalization due to Indian Capital Market: The economic liberalization has led to more deregulation, liberalization and privatization of some of the public sector undertakings in India.

This has resulted in the shares of some of the public sector undertakings being made available to the public. The Industrial policy adopted by the government earlier did not allow investment in core sector by either individuals or private sector. But, with the privatization of some of the public sector undertakings, the shares are now available to the public for contribution.

Promoting more private sector banks: Opening of more private sector banks has resulted in the public contributing to the shares of these banks in Indian capital Market. Recently, the government has announced 74% equity participation by foreigners in private sector banks in India.

Promotion of Mutual Funds: The promotion of mutual funds by nationalized as well as non-nationalized banks has also improved the Indian capital market. They were helpful to the public by way of tax saving schemes.

At present, the condition of some of the mutual funds is very alarming, with the value of their investment going below the face value of the securities. Hence, there is every possibility of the public losing their confidence in the mutual funds.

Regulation of NRI Investments: The Amendment of Foreign Exchange Regulation Act (FERA) into Foreign Exchange Management Act (FEMA) has given more encouragement to nonresident investors.

The percentage of NRI investment in Indian companies has been increased from 5% to 24%. In the year 1991, India faced an acute shortage of foreign exchange and the then finance minister adopted certain methods to improve the foreign exchange reserves.

Direct Foreign Investment: The Foreign Investment Promotion Board, consisting of the Secretaries of industries, finance and foreign affairs, have allowed more direct foreign investment in core sector, especially in power sector.

FERA Companies: Under the Foreign Exchange Regulation Act, a FERA company is one which has 40% equity participation by foreigners. This limit has been removed and now even foreign companies are allowed to have 51% equity participation.

As a result, we are able to attract more foreign capital into Indian capital market. The FERA Act has since been amended and is now known as Foreign Exchange Management Act (FEMA).

Online Trading in Indian Capital Market: Some of the leading stock markets in India have introduced computer system for their trading activities. The brokers can get hooked-up and do their trading on online basis. The computer terminals will enable the public and the brokers to know the price prevailing in the market at any time.

Transparency through online trading: The online trading through computer has brought in transparency to the transactions in the market. People are able to know prices prevailing in the market at any time and as such the brokers cannot deprive their clients of their profits.

National Stock Exchange: A new stock market called National Stock Exchange has been created which a large number of companies have listed. It is a big competitor to the Bombay Stock Exchange and it is able to even influence the Bombay Stock Exchange. The National Stock Exchange deals in shares of companies throughout India and the prices prevailing in the market is a benchmark for stock prices.

Sensitivity Index in Indian Capital Market: The calculation of index number has also undergone a change. Sensitivity index has been introduced which represents important 30 companies whose volume and value of shares determines the market condition.

The sensitivity index is an indication of the conditions prevailing in the market and the conditions that are likely to be encountered by the market.

Circuit-Breaker in Indian Capital Market: A wild fluctuation in the stock market is a thing of the past.

For this purpose, the Bombay stock market has introduced a cut-off switch which is called circuit breaker. Whenever the market index goes up by more than 10%, the circuit breaker will go off, bringing the entire operations in the market to a standstill.

This will be for a period of 30 minutes after which the market will resume. This will bring down the share price.

Demating of shares in Indian Capital Market: The introduction of Demating has resulted in improving transactions further. Demating is a system under which physical delivery of shares is no more adopted. It is called “scrip less trade”.

The shares of individual investors are held by stock holding company and a pass book is given to individual investors. Any sale or purchase of shares will result in entries made in the pass book. The companies concerned are also informed for making due alterations in the share register.

Market Makers in Indian Capital Market: The share price of companies will be decided by the market forces of supply and demand. There are market makers who will ensure the supply and reasonable price for the stocks of companies.

Securities and Exchange Board of India: The creation of Securities and Exchange Board of India (SEBI) is an important development in Indian capital market of India. SEBI has not only replaced the Controller of Capital issues, but has brought in uniformity in the transactions in all stock exchanges.

Over The Counter Exchange of India (OTCEI): For the purpose of newly promoted companies, another stock exchange with lesser degree of conditions has been promoted and it is called Over the Counter Exchange of India (OTCEI).

It may not be possible for all the newly companies to list their shares with the existing stock exchanges. The share capital of these companies will be low and hence there should be an arrangement for listing such companies' shares.

Merchant banker: Merchant bankers have been permitted to take part in the stock market. Their operations and functions are also regulated by SEBI. They not only help companies in capital budgeting but also guide the foreign investors in the purchase of securities. The merchant bankers, through the financial markets, help some of the Indian companies to obtain fresh capital.

Non-Banking Financial Companies: The role of non-financial companies has also been controlled. RBI has introduced new conditions, restricting their activities. New norms with regard to capital of non-banking financial companies have been introduced. For chit funds, a separate Act has been passed and it restricts the maximum bidding to 40%.

Forward trading in Indian Capital market: Forward trading has been introduced since 9th June 2000 in Bombay Stock Exchange on a trial basis and if found successful, it will be extended. It will be helpful to the investors in ascertaining the true colors of existing companies.

Badla transactions in Indian Capital Market: Badla is a transfer of a contract from one period to another, where, either the buyer or the seller is unable to execute the contract for which purpose; the defaulting parties will pay Badla charges (which are decided by the Stock exchange). At present, SEBI has banned Badla transactions.

Restrictions on Mutual Fund's Investment: There have been restrictions on the role of mutual funds in the market. They cannot invest more than 10% of their investable funds in any single company and not more than 10% of single company's issue of shares can be purchased by mutual funds.

Educating Public: Press and media have contributed a lot in popularizing the Indian capital market and they are highlighting the prices of securities every day. The mutual funds and merchant banks have been asked to set apart a portion of their funds towards educating the public on the developments in the Indian capital market.

Government Securities Market: After the stock scam, the Central Government has de-linked Government securities from trading along with company securities. In other words, there will be separate market for Government securities and they will not be dealt along with company securities in the stock market.

Future trading in Indian Capital Market: Future trading is a contract to buy or sell a particular financial instrument on a future date at a specific price. The contract enables the parties to transfer according to the changes in the price from one person to another. By this, the risk is minimized. Thus, the future market provides scope for the traders to minimize their loss or the risks in trading of financial instruments.