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Indian Capital Market: An Overview

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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. The entire paper is divided into three parts. In the first part we have discussed the conceptual framework of the capital market and in the next section, we have focused on the trends in the capital market in India. In the third section, we have discussed various issues and challenges of the capital market in India.

Keywords: Financial system, Capital Market, Development, Problems, Challenges

I. Conceptual Framework of Capital Market

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 :

1) 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.
2) 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. Trends in Capital Market in India

A. Performance of Primary Market

Primary market facilitates 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 common public as a precursor to the trading in secondary market of an exchange. When securities are exclusively offered to the existing shareholders of company, as opposed to the general public it is called Rights Issue. Another mechanism whereby 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.

TABLE1
RESOURCE MOBILIZATION THROUGH PRIMARY MARKET

	2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**
Debt	1603	1500	2500	2,245	4791
Equity	54,511	2,082	46,737	46,678	11647
Private placement	118,485	173,281	212,635	147,400	156,634

(Source: SEBI)

The Indian capital primary market showed a skewed growth. The heat of the financial crisis 2008 was also felt by the primary market when companies put public offer on hold and preferred private as important source of funds mobilization which accounted for about 95% of the total funds. The negative impact of current recession and much awaited reforms could also be observed for the financial year 2011-12. It could be observed that primary debt market in India is not yet mature which range between 1 to 2%. 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 76%**

B.Performance of Mutual Fund Industry

Mutual Funds play an important role in financial services by offering diversification, liquidity and professional management at an affordable price. The Indian Mutual Fund industry consists of 44 players. In addition to advance tax commitments adverse interest rate scenario, slowing growth in India and concerns of global recession were
other important reasons that led to the downfall.

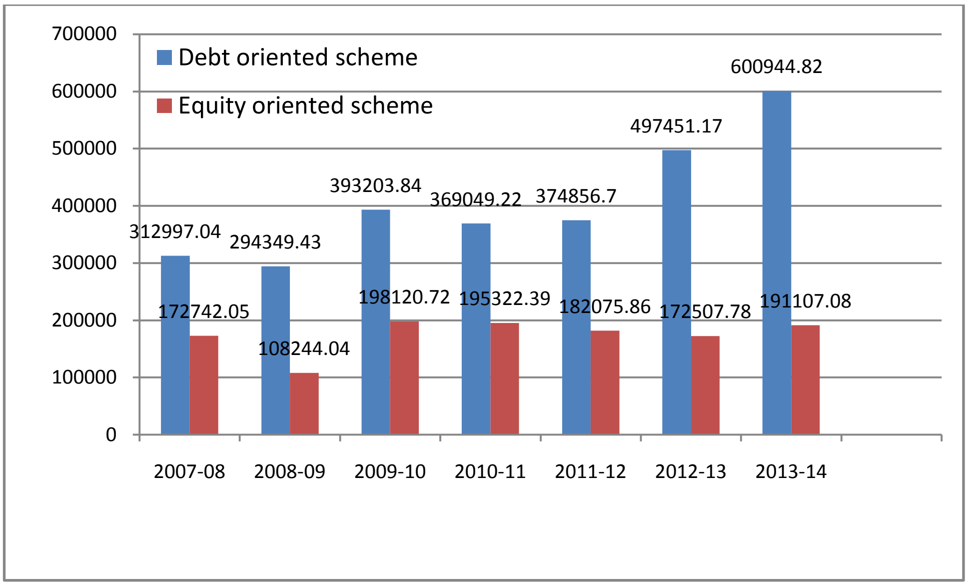

Fig1.Trend of Mutual Fund Investment in Equity and Debt Oriented scheme for the Period 2007-08 to 2013-14 (source: SEBI)

Through out the period from 2007-08 to 2013-14, investors have shown greater confidence in the debt oriented scheme as these are the regular source of income and investors in India are risk averse. Also, the difference in the amount invested in the debt oriented scheme has increased considerably from the year 2012-13 onwards.

C.Performance of FIIs

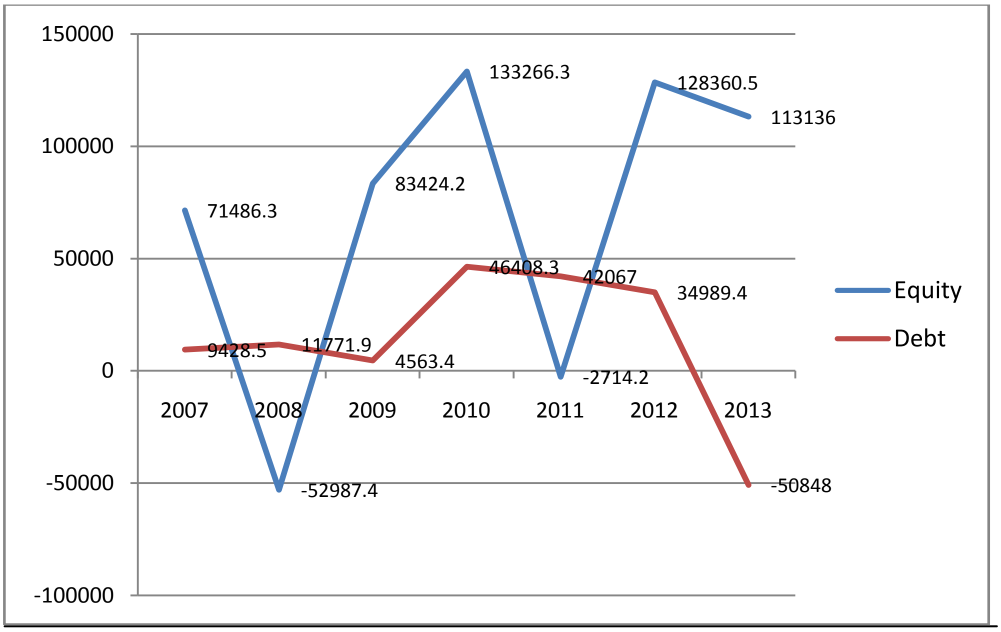

Fig2. Trend of FIIs investment in Debt and Equity market from 2007-13 (source: SEBI)

The foreign institutional investors have always favored investment in equity market over the debt market but whenever there is crisis in the economy then they tend to prefer debt market over the equity market. As we can see in the above figure that in 2008, investment in the equity market was negative where as in case of bond it was low but positive but as the economy started recovering, the investment in equity market tend to higher than the investment in the debt market.

D.Performance of Secondary Market

Sensex and Nifty are the barometer of India'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 trends due to global and domestic factors.

TABLE2
TREND OF MARKET CAPITALIZATION, P/E RATIO, P/B RATIO IN NSE FOR 2007-2013

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Market Capitalization	5138015.26	3086076	6165620.14	6839083.61	6214911.83	6387886.87	7415296.09
P/E Ratio	-	-	-	-	18.50	17.09	17.38
P/B Ratio	-	-	-	-	3.42	2.97	2.78

Market capitalization is the total dollar value of a company's outstanding shares. The BSE shows increasing trend of market capitalization except the year 2008-09 in which economy was in recession. P/B ratio is used to compare a stock's market value to its book value. It is calculated by dividing the current closing price of the stock by the latest quarter's book value per share P/E ratio is the valuation ratio of a company's current share price compared to its per share earnings. Both P/E ratio and P/B ratio shows declining trend through out the period of 2011-12 to 2013-14.

TABLE 3
TREND OF MARKET CAPITALIZATION, P/E RATIO, P/B RATIO IN NSE For 2007-2013

	2007	2008	2009	2010	2011	2012	2013
Market Capitalization	4951.80	5707.75	7236.94	4945.21	3785.33	3021.71	3032.11
P/E Ratio	-	-	-	-	16.75	18.68	18.70
P/B Ratio	-	-	-	-	2.76	3.13	2.99

(Source: SEBI)

The NSE shows fluctuating trend of market capitalization. The P/E ratio is increasing through out the period of 2011-13. The P/B ratio is increasing in 2012 where as it shows declining trend in 2013.

TABLE4
TRADING STATISTIC OF BSE and NSE fron 2007 to 2011

	2007-08	2008-09	2009-10	2010-11	2011-12
BSE	986005	739600	1136513	990776	654137
NSE	1481229	1418928	2205878	1810910	1605205

(Source: SEBI)

The NSE shows increasing trend of quantity of shares delivered where as BSE shows fluctuating trend through out the period of 2007-08 to 2011-12.

E. Performance of Derivative Market

TABLE 5
EQUITY DERIVATIVE SEGMENT OF BSE AND NSE FROM 2007 TO 2011

	2007-08	2008-09	2009-10	2010-11	2011-12
BSE	7453356	496502	9026	5623	32175320
NSE	315552569	644094527	665277652	100170366	1168551087

(Source: SEBI)

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 through out the period from 2007-08 to 2011-12.The BSE shows fluctuating trend for the same.

III.Issues and Challenges of Indian Capital Market

Opening of the financial markets will result in competition and greater efficiency .However, foreign participation will bring increased risk and exposure . Stability is thus need for financial markets for which safeguarding mechanism need to be established.

The equity market in India is extremely vibrant but equity based funding solely, cannot lead the economy to growth. The debt market remains underdeveloped with a huge potential for increased activity. A strong hand is required to drive the long term financing of infrastructure, housing and private sector development.

The road ahead for deepening the capital market need to be paved by the strong linkage between development of economy and the financial system. A greater measure of transparency is also required to built regulating procedures , to bring in a new dimension to financial market and take it to the next level.

One of the challenges before the Indian capital market is expanding the investor base and provide them access to high quality financial service .With a population of more than a billion, a mere 1% of population participates in capital market and of that only a fraction is active. Investor participation is very shallow considering the size of Indian economy

Trading volume in Indian capital market are lower as compared to other markets such as US, China, UK, Germany etc.

Another Challenge faced by the investor is the cost involved in trading, which are comparatively higher in India , than in developed markets

Way Forward to Capital Market

1. Investor education and regulation of mutual fund distributors
2. Allowing AMCs to the flexibility to charge fees
3. Innovative products across different asset classes
4. Amending tax regime to encourage domestic AMCs to manage foreign funds from India
5. Although higher investment by domestic institutional investors such as insurance companies , pension funds to make investment in capital markets
6. Make implementation of proposal of SME stock exchange effective
7. Allowing institutional investors to participate in commodity markets
8. Reduction in current withholding tax of 20% on income from debt securities to encourage investment in debt market.

IV. Conclusion

India being an emerging economy needs innovations and reforms in the financial 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. No doubt that there is a positive correlation between the finance and the economic growth of the country. Economic growth needs sound financial system which further requires the well developed financial market. So, if country wants constant economic growth it has to develop its financial market.

Emerging economies like India depends heavily on the banking system for financing its capital needs. But banks which are highly protected in India hardly fulfill its funding requirements. Thus, there is the need to develop its capital market especially its bond market which is underdeveloped because of policies constraint. Also, India has a huge market for the infrastructure which requires huge funds. 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.

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