A STUDY OF INNOVATIONS IN CAPITAL MARKET AND ITS GROWTH WITH GOVERNANCE

***Dr.B.Chitra, M.Com.,M.B.A., M.Phil., PGDCA., Ph.D**
****Dr.D.Nithya, M.Com.,M.B.A., Ph.D**

***Associate Professor & Head, Department of Commerce with Professional Accounting 'A', PSG College of Arts and Science, Coimbatore – 14.**
***Associate Professor & Head, Department of Commerce with Professional Accounting 'B', PSG College of Arts and Science, Coimbatore – 14.**

INTRODUCTION

Capital Market: A **capital market** is a market for securities (debt or equity), where business enterprises(companies) and governments can raise long-term funds. It is defined as a market in which money is providedfor periods longer than a year, as the raising of short-term funds takes place on other markets (e.g., the moneymarket). The capital market includes the stock market (equity securities) and the bond market (debt).

Two types of Markets : Capital markets may be classified as primary markets and secondary markets. Inprimary markets, new stock or bond issues are sold to investors via a mechanism known as underwriting. In thesecondary markets, existing securities are sold and bought among investors or traders, usually on a securitiesexchange, over-the-counter, or elsewhere.

INDIAN CAPITAL MARKET

Evolution: Indian Stock Markets are one of the oldest in Asia. Its history dates back to nearly 200 years ago.The Bombay Stock Exchange was inaugurated in 1899 when the brokers formally established a stock market InIndia. Thus, the Stock Exchange at Bombay was consolidated. After that more & more stock exchanges haveemerged in India & this forms a huge capital market in India.

EQUITY MARKET IN INDIA

The Indian Equity Market is more popularly known as the Indian Stock Market. The Indian equity market hasbecome the third biggest after China and Hong Kong in the Asian region. According to the latest report byADB, it has a market capitalization of nearly $600 billion.

INNOVATIONS IN THE CAPITAL MARKET

Stock Exchange: Stock Exchange is an Organized and regulated financial market where securities (bonds, notes, shares) are bought and sold at prices governed by the forces of demand and supply.

The Role of Stock Exchanges: Stock exchanges have multiple roles in the economy. This may include the following ,

Raising Capital For Businesses: The Stock Exchange provide companies with the facility to raise capital for expansion through selling shares to the investing public.

Facilitating Company Growth: A takeover bid or a merger agreement through the stock market is one of the simplest and most common ways for a company to grow by acquisition or fusion.

Creating Investment Opportunities For Small Investors: As opposed to other businesses that require huge capital outlay, investing in shares is open to both the large and small stock investors because a person buys the number of shares they can afford. Therefore the Stock Exchange provides the opportunity for small investors to own shares of the same companies as large investors.

Barometer of the Economy: At the stock exchange, share prices rise and fall depending, largely, on market forces. Share prices tend to rise or remain stable when companies and the economy in general show signs of stability and growth. An economic recession, depression, or financial crisis could eventually lead to a stock market crash. Therefore the movement of share prices and in general of the stock indexes can be an indicator of the general trend in the economy.

Speculation: The stock exchanges are also fashionable places for speculation. In a financial context, the terms "speculation" and "investment" are actually quite specific. For instance, although the word "investment" is typically used, in a general sense, to mean any act of placing money in a financial vehicle with the intent of producing returns over a period of time, most ventured money—including funds placed in the world's stock markets—is actually not investment but speculation.

The Indian market has 22 stock exchanges. The larger companies are enlisted with BSE and NSE. The smaller and medium companies are listed with OTCEI (Over The counter Exchange of India).

- **Derivative Markets :**The emergence of the market for derivative products such as futures and forwards can be traced back to the willingness of risk-averse economic agents to guard themselves against uncertainties arising out of price fluctuations in various asset classes. This instrument is used by all sections of businesses, such as corporate, SMEs, banks, financial institutions, retail investors, etc. According to the International Swaps and Derivatives Association, more than 90 percent of the global 500 corporations use derivatives for hedging risks in interest rates, foreign exchange, and equities. Three broad categories of participants—hedgers, speculators, and arbitragers—trade in the derivatives market.

 Hedgers face risk associated with the price of an asset. They belong to the business community dealing with the underlying asset to a future instrument on a regular basis. They use futures or options markets to reduce or eliminate this risk.

 Speculators have a particular mindset with regard to an asset and bet on future movements in the asset's price. Futures and options contracts can give them an extra leverage due to margining system.

 Arbitragers are in business to take advantage of a discrepancy between prices in two different markets. For example, when they see the futures price of an asset getting out of line with the cash price, they will take offsetting positions in the two markets to lock in a profit.

➢ DEBT MARKET IN INDIA

Debt market refers to the financial market where investors buy and sell debt securities, mostly in the form of bonds. These markets are important source of funds, especially in a developing economy like India. India debt market is one of the largest in Asia.

The most distinguishing feature of the debt instruments of Indian debt market is that the return is fixed. This means, returns are almost risk-free. This fixed return on the bond is often termed as the 'coupon rate' or the 'interest rate'. Therefore, the buyer (of bond) is giving the seller a loan at a fixed interest rate, which equals to the coupon rate.

❖ Classification of Indian Debt Market

Indian debt market can be classified into two categories :

- Government Securities Market (G-Sec Market)
- Bond

Debt Instruments

There are various types of debt instruments available that one can find in Indian debt market.

- Government
- Corporate
- Certificate of Deposit
- Commercial
- Zero Coupon bonds (ZCBs)

❖ Private Corporate Debt Market

The private corporate debt market provides an alternative means of long-term resources (alternative to financing by banks and financial institutions) to corporate. Corporates in India have traditionally relied heavily on borrowings from banks and financial institutions (FIs) to finance their investments. Equity financing was also used, but largely during periods of surging equity prices. However, bond issuances by companies have remained limited in size and scope. Given the huge funding requirements, especially for long-term infrastructure projects, the private corporate debt market has a crucial role to play and needs to be nurtured.

❖ **Private Placement Market in India**

In private placement, resources are raised privately through arrangers (merchant banking intermediaries) who place securities with a limited number of investors such as financial institutions, corporate and high net worth individuals. Under Section 81 of the Companies Act, 1956, a private placement is defined as 'an issue of shares or of convertible securities by a company to a select group of persons'. An offer of securities to more than 50 persons is deemed to be a public issue under the Act.

Corporate access the private placement market because of its certain inherent advantages

REGULATORY FRAMEWORK

The Securities and Exchange Board of India (SEBI) is the regulatory authority established under the SEBI Act 1992, in order to protect the interests of the investors in securities as well as promote the development of the capital market. It involves regulating the business in stock exchanges; supervising the working of stock brokers, share transfer agents, merchant bankers, underwriters, etc; as well as prohibiting unfair trade practices in the securities market.

➢ **The basic objectives of the Board were identified as :**

- to protect the interests of investors in securities;
- to promote the development of Securities Market;
- to regulate the securities market and
- For matters connected therewith or incidental thereto.

THE INDIAN CAPITAL MARKET: GROWTH WITH GOVERNANCE

A report released by PricewaterhouseCoopers (PwC) and ASSOCHAM, charts the journey of the Indian capital market from the pre-reform era to the liberalised market of this decade. The report emphasises the importance of SEBI, as the supreme regulator of the Indian capital market, and the various steps taken by SEBI to maintain investor confidence in the market. The report states that while, India has achieved the desired acceptability on the global map, however the change must continue, to address the challenges of modern day, newer products needs to be introduced to ensure that innovation continues, while ensuring market best practices to take Indian capital markets to the next level of globalisation. The imperative need to bring forward 2nd generation financial sector reforms will propel the Indian capital markets to possibly double digit GDP growth.

The capital market plays a vital role in fostering economic growth of the country, as it augments the quantities of real savings; increases the net capital inflow from abroad; raises the productivity of investments by improving allocation of investible funds; and reduces the cost of capital in the economy.

REFORMS IN CAPITAL MARKET

The **major** reform undertaken in capital market includes :

- **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.
- **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.
- **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.
- **Rising Electronic Transactions:** Due to technological development in the last few years. The physical transaction with more paper work is reduced. 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.
- **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.
- **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.
- **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.
- **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.
- **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.

These reforms have resulted into the tremendous growth of Indian capital market.

THE BENEFITS OF CAPITAL MARKET INNOVATION

Following are the benefits that flow from the integration and sophistication of capital markets. These are of two kinds, macro-economic and micro-economic.

At the macro-economic level, capital market innovation enlarges the menu of assets available to saver sand borrowers. By designing savings vehicles in a more attractive way and extending the reach offinancial intermediation, saving is encouraged, and the utility of a given volume of savings to the holdersof financial assets in enhanced. Similarly on the borrowing side: the introduction of new borrowing instruments facilitates capital formation and, perhaps even more important, helps improve its quality. If secure and liquid financial assets are readily available, yielding competitive real rates of interest, savings are less likely to be retained by firms for low-productivity investments, or diverted into inflation hedges.

Another macro-economic benefit springs from closer international links among capital markets and financial institutions. The integration of capital markets across borders makes it easier for savings arising in mature economies to be used to finance higher-yielding investment opportunities in economies with higher growth potential. This promotes economic growth in two ways: by improving the efficiency of investment; and by strengthening the discipline on governments and central banks to pursue sound policies

At the micro-economic level, the development of new financial instruments improves the capacity of financial intermediaries and end-users of financial markets to manage risks. Better risk management, in turn, leads to the improved allocation of resources, in particular capital.

Any discussion of risk management leads directly to consideration of the role of derivatives. Derivatives are, above all, a means of “unbundling” risks into various elemental components, such as credit risk, interest rates risk, exchange rates risk and so on. This enables the various risk components to be more clearly identified and priced, and if necessary traded. Derivatives therefore facilitate the adjustment of risk exposures for speculative or hedging purposes. This helps to redistribute risks in the economic system to those most willing, and presumably most able, to bear and manage them.

Derivatives can be tailored to the particular risk management needs of customers. They thereby allow the creation of pay-off characteristics – or heading possibilities – at a lower cost than would result from the acquisition of underlying assets. This is particularly valuable for those who manage large portfolios such as insurance companies and pension funds, as well as for multinational companies that have streams of payments and receipts subject to the multiple uncertainties of commodity price, exchange rate and interest rate fluctuations.

Another benefit from derivatives markets is the improvement they bring to the mechanism for pricing risks. By enabling composite risks to be broken down into their elemental components, they improve pricing efficiency, and thus the allocation of scarce capital that is needed to cushion risk.

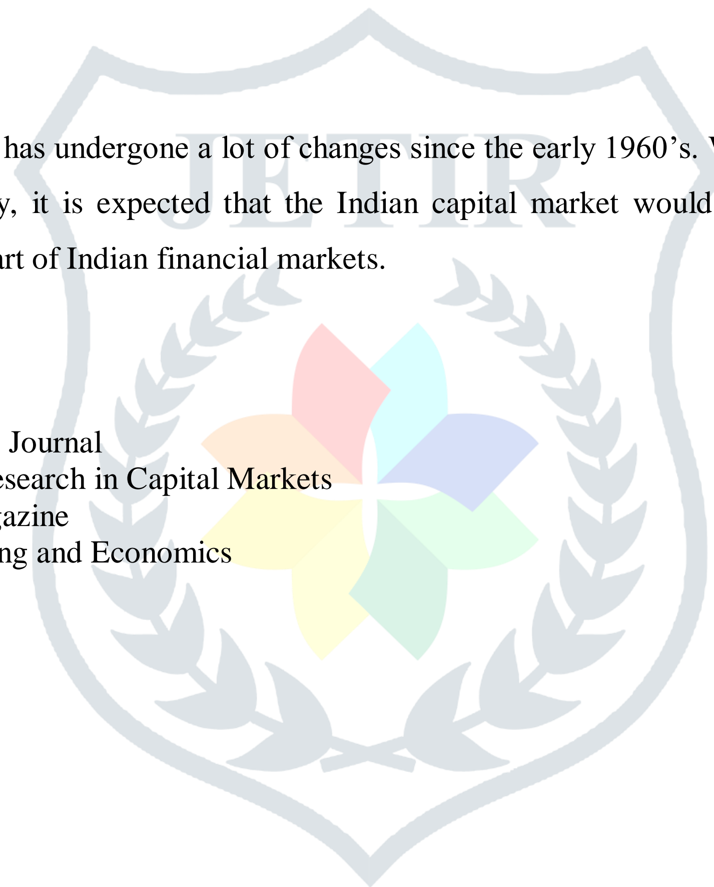
Lastly, derivatives facilitate investment and arbitrage strategies that straddle market segments. They increase asset substitutability, both domestically and internationally. This improves liquidity in individual markets and, it is to be hoped, allows disturbances to be diffused, thus making the overall system more resilient.

In all of these ways, capital market innovations move us towards what are technically known as "complete markets". In this way, they allow market participants to insure themselves against "state of the world" that might adversely affect their business. This is a tremendous advantage. All economic activity involves risk.

But if we can allow business and individual to focus on those risks they know and understand, while hedging those risks that are incidental to their main business activity, then efficiency will be improved and long-term investment will be more attractive. To take a simple example: an oil company is more likely to undertake an investment if it can confine its uncertainty to exploration and drilling risk, while buying protection against exchange rate and interest rate risk from financial intermediaries. Financial creativity can improve the risk-return frontier facing individual participants in the real sector of the economy.

CONCLUSION

The Capital Market has undergone a lot of changes since the early 1960's. With the introduction of new innovations and technology, it is expected that the Indian capital market would soar to greater heights and become an indispensable part of Indian financial markets.



References:

1. Capital Market Law Journal
2. Indian Journal of Research in Capital Markets
3. Capital Market Magazine
4. Journal of Accounting and Economics