

CAPITAL MARKET REFORMS IN POST GLOBALISATION ERA

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Abstract

This study is based on conceptual framework that draws an attention on the theory of regulations and wide-ranging reforms that have been initiated in the Indian capital market over the last two decades. India implemented significant reforms to foster development in capital markets. The prime objectives to bring these reforms were improving market efficiency, transparency, and preventing unfair trade practices.

With the globalisation, financial markets are becoming more and more important every day. A developed capital market is considered crucial to national economic growth as it provides an additional channel along with banks and other financial institutions, for encouraging and thus mobilising domestic savings. It also ensures improvements in the productivity of investment through market allocation of capital and increases managerial discipline through the market for corporate control. A study by 'World Institute for Development Economic Research' WIDER, 1990) has argued that the developing countries should liberalise their financial markets in order to attract foreign portfolio equity flow. The huge amount of financial capital available in the developed countries through pension and investment funds could be attracted to the developing countries provided the latter liberalised their markets externally and developed their stock market internally. Capital markets have taken a prominent place in the developing countries' financial system during the last decade. Indian capital market faced a series of reforms started in the late 1980s with the establishment of Securities and Exchange Board of India (SEBI). These gained the substantial momentum with the consolidation of all regulatory authorities with SEBI in 1992. The present study shows both sides of the coins as it elaborates the pros and cons of the reforms implemented. This study has found significant improvement in the economy after liberalization as capital market reforms that started in 1990s contributed to the development in the stock markets in India.

Introduction:

A healthy and vibrant capital market is important for economic reform and development. Efficient stock markets encourage individuals to invest in shares and give correct signals to company managers to maximize shareholder wealth. The allocative efficiency of financial systems based on securities markets also depends upon the extent to which security prices in the secondary market reflect the risk and return of alternative securities. It is therefore important to check if markets are efficient and to examine the factors that contribute to it.

There have been a number of major changes in the economic and financial policies in India since 1991. Liberalisation, globalisation and market reforms have had an impact on the functioning of the capital market. Reports from other markets have shown that reforms and liberalization have led to increased efficiency. Over a period, the Indian securities market has undergone remarkable changes and grown exponentially, particularly in terms of resource mobilisation, intermediaries, the number of listed stocks, market capitalisation, turnover and investor population.

The following paragraphs list the principal reform measures undertaken since 1992.

1. Creation of Market Regulator:

Securities and Exchange Board of India (SEBI), the securities market regulator in India, was established under SEBI Act 1992, with the main objective and responsibility for (i) protecting the interests of investors in securities, (ii) promoting the development of the securities market, and (iii) regulating the securities market.

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 organising, consultancy services, etc. It has proved as a helping hand to factors related to the capital market.

4. Screen Based Trading:

Prior to setting up of NSE, the trading on stock exchanges in India was based on an open outcry system. The system was inefficient and time consuming because of its inability to provide immediate matching or recording of trades. In order to provide efficiency, liquidity and transparency, NSE introduced a nation-wide on-line fully automated screen based trading system (SBTS) on the capital market segment on November 3, 1994.

5. Reduction of Trading Cycle:

Earlier, the trading cycle for stocks, based on type of securities, used to vary between 14 to 30 days and the settlement involved another fortnight. The Exchanges, however, continued to have different weekly trading cycles, which enabled shifting of positions from one Exchange to another. It was made mandatory for all Exchanges to follow a uniform weekly trading cycle irrespective of scrips not under rolling settlement. In December 2001, all scrips were moved to rolling settlement and the settlement period was reduced progressively from T+5 to T+3 days. From April 2003 onwards, T+2 days settlement cycle is being followed.

6. Equity Derivatives Trading:

In order to assist market participants in managing risks better through hedging, speculation and arbitrage, Securities Contract (Regulation) Act was amended in 1995 to lift the ban on options in securities. Trading in derivatives, however, took off in 2000 with index futures after suitable legal and regulatory framework was put in place. The market presently offers index futures, index options, single stock future and single stock options.

7. Demutualisation:

Demutualization is the process by which a customer-owned mutual organization or co-operative changes legal form to a joint stock company. **The process of demutualising all the broker-run exchanges in India actually started with the Bombay Stock Exchange which was demutualised in August 2005. Demutualisation was mandated by the government as a regulatory measure directed at ending the brokers' control over the exchanges.** Prior to this reform, stock exchanges were owned, controlled and managed by the brokers. In case of disputes, integrity of the stock exchange suffered. NSE, however, was set up with a pure demutualised governance structure, having ownership, management and trading with three different sets of people. Currently, all the stock exchanges in India have a demutualised set up.

8. Dematerialisation:

As discussed already, the old settlement system was inefficient due to (i) the time lag for settlement and (ii) the physical movement of paper-based securities. To obviate these problems, the Depositories Act, 1996 was passed to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed and accuracy. There are two depositories in India, *viz.* National Securities Depository Limited and Central Depositories Securities Limited. These have been set up to provide instantaneous electronic transfer of securities. Demat (Dematerialised) settlement has eliminated the bad deliveries and associated problems. To prevent physical certificates from sneaking into circulation, it has been made mandatory for all newly issued securities to be compulsorily traded in dematerialised form. Now, the public listed companies making **IPO** of any security for Rs.10 crore or more have to make the IPO only in dematerialised form.

9. Clearing Corporation:

The anonymous electronic order book ushered in by the NSE did not permit members to assess credit risk of the counter-party and thus necessitated some innovation in this area. To address this concern, NSE had set up the first clearing corporation, *viz.* National Securities Clearing Corporation Ltd. (NSCCL), which commenced its operations in April 1996.

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. Investor Protection:

In order to protect the interest of the investors and promote awareness, the Central Government (Ministry of Corporate Affairs) established the Investor Education and Protection Fund (IEPF) in October 2001. With the similar objectives, the Stock Exchanges and SEBI also maintain investor protection funds to take care of investor claims. SEBI and the stock exchanges have also set up invest orgrievance / service cells for redress of investor grievance. All these agencies and investor associations also organise investor education and awareness programmes.

12. Globalisation:

Indian companies have been permitted to raise resources overseas through issue of ADRs, GDRs, FCCBs and ECBs (American Depository Receipts, Global Depository Receipts, Foreign Currency Convertible Bonds and External Commercial Borrowings). Further, FIIs have been permitted to invest in all types of securities, including government securities and tap the domestic market. The investments by FIIs enjoy full capital account convertibility. They can invest in a company under portfolio investment route upto 24% of the paid up capital of the company. This can be increased up to the sectoral cap/statutory ceiling, as applicable to the Indian companies concerned, by passing a resolution of its Board of Directors followed by a special resolution to that effect by its general body. The Indian stock exchanges have been permitted to set up trading terminals abroad. The trading platform of Indian exchanges is now accessible through the Internet from any where in the world. RBI permitted two-way fungibility for ADRs / GDRs, which means that the investors (foreign institutional or domestic) who hold ADRs / GDR can cancel them with the depository and sell the underlying shares in the market.

13. Launch of India VIX:

Volatility index is a measure of market's expectation of volatility over the near term. It measures the amount by which an underlying Index is expected to fluctuate in the near term, based on the order book of the underlying index options. India's first volatility index, India VIX (based on the Nifty 50 Index Option prices) was launched by NSE in April 2008.

14. Direct Market Access:

In April 2008, SEBI allowed the direct market access (DMA) facility to the institutional investors.

DMA allows brokers to offer their respective clients, direct access to the Exchange trading system through the broker's infrastructure without manual intervention by the broker.

15.Launch of Securities Lending & Borrowing Scheme:

In April 2008, the Securities Lending & Borrowing mechanism was allowed. It allows Market participants to take short positions effectively with less cost.

16.Launch of Currency Futures:

On August 29, 2008, NSE launched trading in currency future contracts in the USD-INR pair for the first time in India. Trading mother currency pairs like Euro — INR, Pound

Sterling — INR and Japanese Yen was further made available for trading in March 2010.

17.ASBA:

Application Supported by Blocked Amount (ASBA) is a major primary market reform. It enables investors to apply for IPOs / FPOs and rights issues without making a payment. Instead, the amount is blocked in investors' own account and only an amount proportionate to the shares allotted goes out when allotment is finalized.

18.Launch of Interest Rate Futures:

On August 31, 2009, futures on interest rate was launched on the National Stock Exchange.

19.Issue of Capital and Disclosure Requirements (ICDR) Regulations 2009:

In August 2009, the SEBI issued Issue of Capital and Disclosure Requirements (ICDR)Regulations 2009, replacing the Disclosure and Investor Protection (DIP) Guidelines2000. ICDR Regulations 2009 would govern all disclosure norms regarding issue of securities.

Liberalisation, globalisation and market reforms have had an impact on the functioning of the market. As it is not possible to separate the effects of liberalisation, globalisation and marketreforms, the combined effect of these developments and their impact on the Indian capitalmarket have been examined by researchers. Maiti (1997) documented the tremendous growthof stock exchanges and market capitalisation up to 1994. Malhotra (1998) found a positive impact of this process on economic growth, savings and investment from 1988-89 to 1994-95.

Shah (1999) traces the transformation of the market due to reforms fr0m1994-98. The market nessed fundamental institutional changes resulting in drastic reduction in transaction costs and significant mprovements ;II transparency and safety.

Table 1
 Trend of Market Capitalisation in the Indian Stock Market

March end	Market Capitalisation (RsCrore)
1991	110,279
1992	354,106
1993	228,780
1994	400,077
1995	473,349
1996	572,257
1997	488,322
1998	589,816
1999	574,064
2000	1,192,630
2001	768,863
2002	749,248
2003	631,921
2010	6,059,183
2011	6,702,616
2012	5,695,547

Source : NSE (Indian Securities Market in India – Review) and
 RBI (Handbook of statistics on the Indian Economy)

Trend of Market Capitalisation in the Indian Stock Market

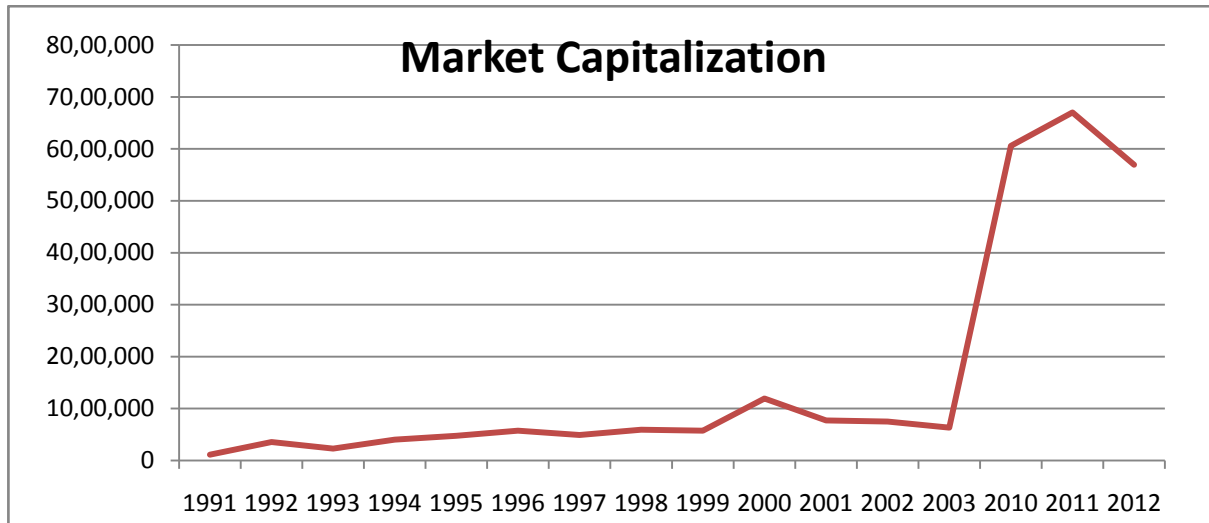


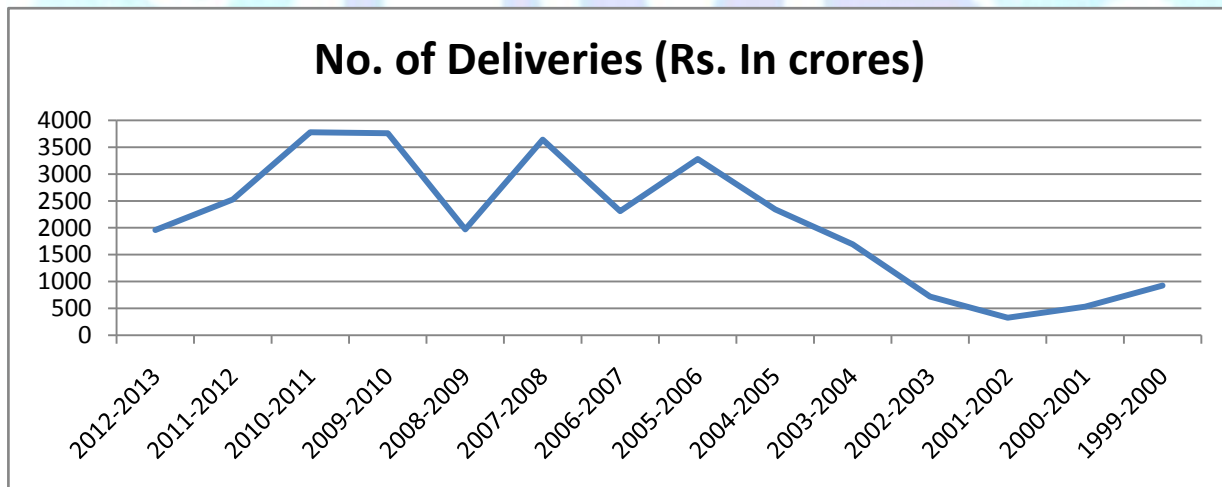
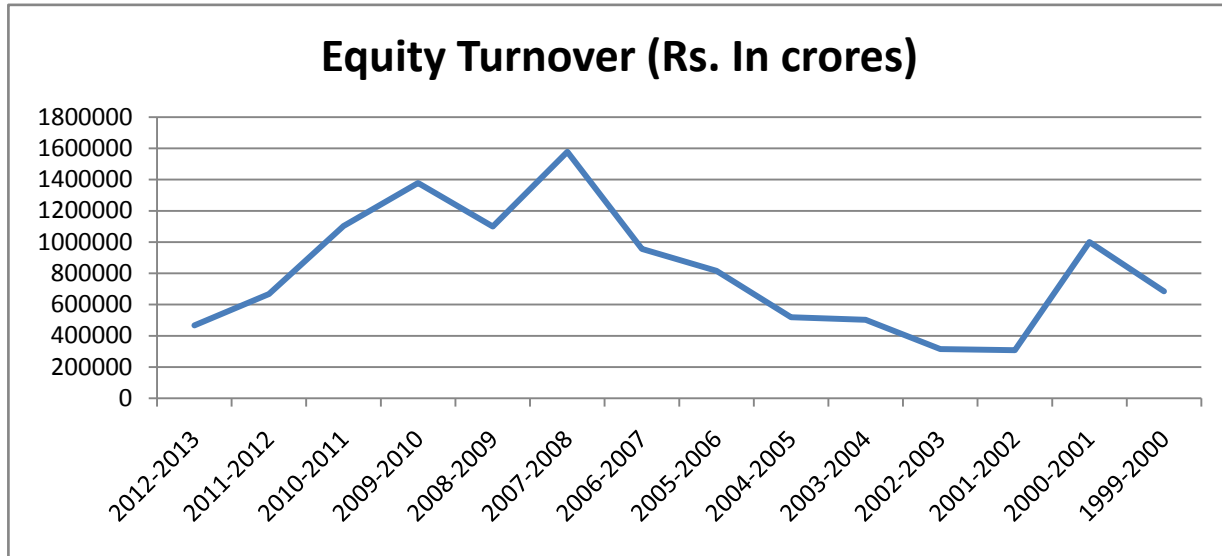
Table 1 shows the continuous increase in trend of market capitalization ranging between Rs. 110279 crores to Rs. 6,702,616crores. The same trend is followed by equity turnover and number of deliveries respectively from the period 2000 to 2013.

Table 2
Equity Turnover and Number of Deliveries in the Indian Stock Market

Year	Equity Turnover (Rs. Cr.)	No. of Deliveries (Cr.)
2012-2013	466748.69	1958.97
2011-2012	667022.43	2528.08
2010-2011	1103466.40	3779.47
2009-2010	1378809.00	3762.50
2008-2009	1100073.60	1969.95
2007-2008	1578856.10	3641.62
2006-2007	956185.41	2310.43
2005-2006	816074.02	3281.53
2004-2005	518715.67	2342.05
2003-2004	502618.40	1693.74
2002-2003	314073.19	719.17
2001-2002	307292.37	325.59
2000-2001	1000031.50	530.82
1999-2000	685028.21	925.89

Source : www.nseidnia.com, bseindia.com

Equity Turnover (Rs. Crore)



Capital market reforms attracted Foreign Institutional Investors too to invest in Indian securities market. The rally in the market reforms period was a rally of hope for FIIs. Many experts consider FIIs to be "Fair Weather Friends", who come in bulk when there is money to be made and leave abruptly at the first sign of impending trouble in the host country, thereby inducing undesirable risk and uncertainty into markets. There is another set of experts who believe that FIIs are life blood for an emerging economy like India. They augment domestic saving without increasing foreign debt, provide vital liquidity to Indian companies to sustain road to growth, reduce cost of equity capital and help reduce deficit of Balance of payments (BOP). Also these experts believe that FIIs, like any other investors buy or sell according to prevailing sentiments in the market, rather than creating any

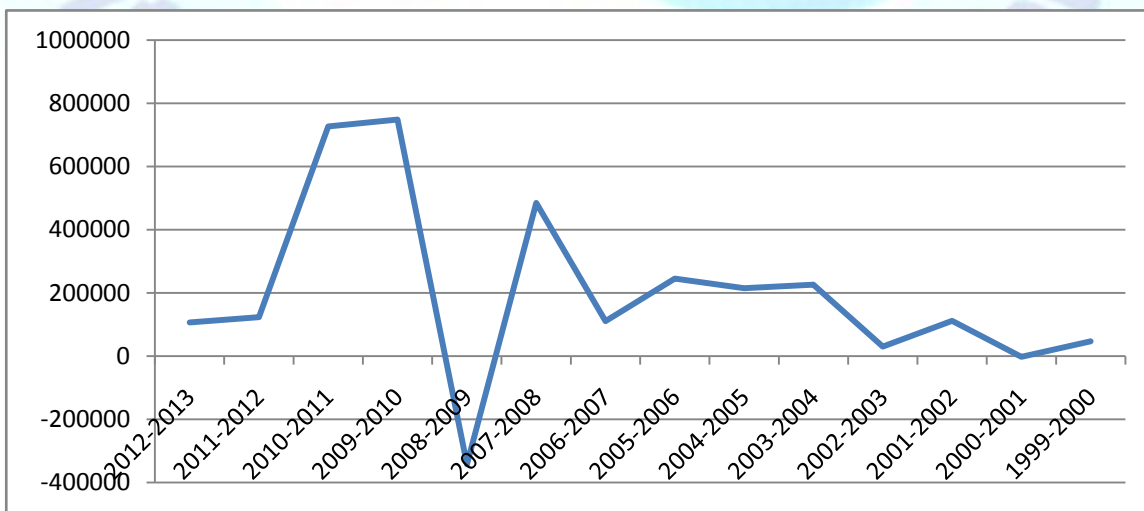
sentiments that drive the markets. Hence there lies a conflict between the pros and cons of Ms and the all important question regarding the role of FIIs in deciding the fate of our stock markets. Table 3 depicts the status of buying and selling behavior of PHs over the past years. Due to capital reforms it also intends to move upward.

Table 3
Status of FII s over the past years

Year	Buy	Sell	Net
2012-2013	552882.1	47889942	106468.7
2011-2012	4019122.7	3895766.5	123356.2
2010-2011	4879817.3	4153085.6	726731.7
2009-2010	4690231	3941593	748638
2008-2009	4176346	4518855	-342509
2007-2008	5371212	4886467	484745
2006-2007	3104267	2993494	110773
2005-2006	1893614.8	1648116.6	245498.2
2004-2005	1191560.5	976747.8	214812.7
2003-2004	795739	569565	226174
2002-2003	315956.8	285817	30139.8
2001-2002	374944.7	263063.4	111881.3
2000-2001	391625.81	393629.21	-2003.4
1999-2000	243343	196672	46671

Source : www.bseindia.com

Net status of FIIs over the past years



Conclusion:

Reforms of the Indian capital markets have long been overdue; liberalization of onerous disclosure requirements, better price discovery mechanism and entry of foreign companies in Indian markets would provide the necessary fillip for overall growth of the economy. An active market for foreign companies in India is likely to attract investment from wider avenues, both domestic and foreign and consequently be beneficial to domestic companies already listed or waiting to be listed on Indian bourses. Greater participation from global institutional investors also assures greater liquidity and enhanced reputation of the market, leading to better valuations for companies listed on Indian exchanges. In addition, such reforms would also have ancillary benefits like job creation in financial cities of India and exposure to global best practices in corporate-securities law.

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