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Indian Capital Market and Financial Reforms

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The Indian economy has witnessed wide-ranging reforms under the guise of liberalisation, privatisation and globalisation (LPG). An important area where upgradation (through reforms) has been phenomenal is the Indian Capital Market. A complete metamorphosis of the law, trading, clearing & settlement mechanisms and procedures and the instruments traded has evolved. This paper, while highlighting the cardinal changes, examines their impact on macroeconomic environment The concluding section looks at "what needs to be done" for bringing the Indian Capital Market at the forefront of Global Institutions.

The Government of India initiated reform measures during 1991 -92 under compulsions and not just as a choice as the Indian Economy had to Face Severe Financial Crisis where in inflation rate was moving up in two digits, Fiscal deficit was widening and most importantly the foreign exchange reserve reduced to alarming level. Several factors contributed to this debacle. Indian Economy, before the reform process, was a closed economy and all the sectors of economy were closely regulated and this shape of economy was making it unattractive for the rest of world. Because of these factors India experienced low level of foreign investment which was urgently needed to Finance the imports.

The Economic reforms in India, initiated in 1991, were based on the premise that 'macro-economic' inefficiencies that distort the structure of incentives to producers. After short period of IMF Style 'Stabilisation', with the usual package of devaluation, temporary import compression and Fiscal and monetary contraction accompanied by a sharp increase in interest rates in the economy, the main focus of the reforms programme has been confined to what is known as "Structural adjustment".

Economic reforms were the new dress code for the economy. These economic reforms were not confined to one or two sector of economy rather they covered whole economy by dividing in to different parts. The sectors in which economic reforms were started include; External Sector, Banking, Financial Sector, Commerce, Infrastructure, Taxation, Insurance, Space & Technology etc. The new mantra for economy was Liberalisation, Privatisation, Globalisation (LPG). The whole efforts were concentrated upon to make it attractive on international stage so that Foreign Financial Flows may be regular phenomenon for the economy.

Economic reforms were started through change in economic policy with regard to industrial licensing, export- import policy, technology upgradation, Fiscal policy, foreign equity capital, removal of control and restrictions, rationalizing and simplifying the system of fiscal and administrative regulations. However, the desired objectives can not be achieved unless parallel Financial Sector reforms were initiated. Financial sector includes banking sector and capital maket.

Financial sector reforms process was started with the establishment of Narsimham Committee in 1991. The objective behind appointment of this committee was to study the economy at a large and to put a proposal for reform measures to be taken by the Government in order to remove the deficiencies in this particular sector. Financial sector reforms were discussed under three broad categories:

(a) Banking Sector reforms.
(b) Capital Market reforms.
(c) Insurance Sector reforms.

Capital market plays an important role in Capital formation of a country. The function of the Capital market covers (i) Securities market (primary and secondary) (ii) Debt market (iii) Money market. The Function of the securities market or Stock market is two-fold : (a) to arrange for the raising of new Capital (primary market function) (b) to provide liquidity to existing securities (Secondary market Function).

Prior to the onset of reforms in 1991, Capital market structure was unsuitable for economic development since it was unattractive for investors because of its faulty structure. Capital market structure in India was subject to several controls and opaque procedure. There was multiplicity of control over capital market players and operators. Raising of Capital from Securies market was regulated by the Capital Issues (Control) Act 1947. Guidelines issued by RBI and ministry of Finance were also regulating the capital market activities. So, because of this multiplicity of control, market operators were more or less Free From any external control. By taking advantage of the situation, they were turning the market in their favour as it evident from scams registered at that time.

As per the recommendation of Narsimham Committee first step was taken in this regard by repealment of Capital Issue (Control) Act 1947. With this all controls relating to raising of funds from the market comes to an end. There was new market regulator in the market called Securities Exchange Board of India (SEBI). SEBI was the sole regulator of Capital market participants.

Now, all the market players and intermediaries are required to take certificate of registration to start their activities through a well defined procedure drafted by SEBI. Issuers of capital are required to meet the guidelines of SEBI on disclosures and protection of investors. There are code of conduct which are mandatory for all the market participants so that they may discharge their duties in the best interest of investors and capital market as a whole. All the market participants are required to maintain proper records of their functioning under SEBI regulations and they are also required to submit the timely report of the same to the SEBI and to the investors. SEBI also imposed penalties which may be either suspension /cancellation of registration, if default is found during investigations. All reforms measures adopted by SEBI may be divided into three categories:

- Structural Reforms. • Strategic Reforms.
- Administrative Reforms.

First of all formation of SF.BI was itself a biggest Structural reforms. SEBI initiated some structural changes by issuing regulations in regard to: insider trading. Euro issue. Depositories. Buy-back, central database of market participants etc. These structural changes were essential for the proper development of capital markets as well as for a definite direction of the pace of development.

Strategic reforms where needed for development of efficiency of the system and internationalization of the capital market. The strategic actors include- market makers, disclosure standards for corporate. central listing authority and rules regarding Indian depository receipt.

Administrative reforms were initiated by the SEBI so as to ensure proper administration of the stock exchanges and its participants. SEBI issued administrative measures to regulate and monitor the working of stock exchange and major market intermediaries, like; merchant bankers, stock brokers, Debenture Trustee, Portfolio managers, mutual funds, underwriters etc.

National Stock Exchange (NSE):

The NSE was incorporated in November 1992 with an equity capital of 25 crores. The International Securities consultancy (ISC) of Hong-Kong has helped in setting the NSE. Financial Institutions, Insurance Companies, Banks, Stock Holding Corporation Ltd. were all promoters of the NSE. It aims at promoting professionalism in the capital market and providing better securities trading facilities to investors nationwide. NSE transcends geographical barriers and overcomes fragmentation by providing a screen based trading system instead of the conventional trading ring. This results in greater depth and liquidity of the market and reduces the transaction costs. The objectives of NSE are to :

(i) Provide a nationwide trading facility for equities, debt instruments and hybrids.
(ii) Ensure equal access to investors all over the country through an appropriate communication network.
(iii) Provide a fair, efficient and transparent securities market to investors using electronic trading systems.
(iv) Enable shorter settlement cycles and book entry settlement systems.
(v) Attain current international standards of securities market.

NSE pioneered many important innovations in market design in India. The most important of these included nationwide electronic trading (1994), the Clearing Corporation as a central counter party (1996) and paperless settlement at the depository (1996). NSE was a pioneer amongst security exchanges in the world in using a "demutualised" structure where brokerage firms did not own the exchange.

As an impact of financial sector reforms process several changes have occurred in primary and secondary capital market, which have been discussed in the following paragraphs :

(i) Capital mobilization through primary capital market shown erratic behaviors. These ups and downs may be accounted far various macro economic factors.

(ii) In past, equity was the sole instruments for issue of capita! but now debenture have also emerged as the flavour for issue because of its benefits and investors confidence in securities market.

(iii) The private sector has taken lead in mobilizing the highest amount as compared to public and joint sectors, as private sector accounted far 96.48% of the total capital raised in 2000-01.

(iv) Indian companies are allowed to raise the Foreign Funds through 'EURO issue' within the framework of guidelines issued by regulatory bodies. Now, Indian companies are better recognized in the eyes of foreign investors as it was reflected from increasing trend in quantum of 'EURO issue'.

(v) In order to make capital market attractive, SEBI has allowed buy-back of shares by the companies.

(vi) At present 23 Stock Exchanges are working in India. There has been continuous growth in listed stock. Number of listed companies has increased from 6229 in 1990- 91 to 9413 in 2002-03.

(vii) Now, investors are showing greater confidence in capital market which is reflected from their increasing participation.

(viii) Secondary market has shown positive signals through its indicators. As number of brokers has increased from 6711 in 1994-95 to 9519 in 2002-03, turnover has increased from Rs. 203703 or. In 1993-94 to Rs. 986908 cr. In 2002-03.

(ix) The impact of financial sector reforms can also be looked in the operations of market participants, nainely- mutual funds, FIIS, Depositories, stock brokers, sub-brokers etc. Their participation in capital market has increased a lot. They are better regulated than before.

As a result of financial reforms measures, Indian Capital market is registering its presence on global map and now Indian bourses are internationally recognized.

Indian capital market has undergone many changes because of reforms. But still there is plenty of scope for future capital market changes in order to fulfill expectations of domestic and foreign investors. The prospective vision of Indian Capital market may be discussed under the following paragraphs:

(i) With the change in the investment habit of investors, there will be more capital formation if, the Indian Stock Exchanges reflect a satisfactory performance, (ii) Policy of liberalisation, globalisation, and privatisation will facilitate more global financial flow into the country, (iii) Heavy corporatisation of business will surely lead to more corporate listing on the stock exchanges and that will help to increase the turnover of the stock exchanges, (iv) Low interest rate environment will lead to more investment in capital market because it will be unattractive to keep the savings with banks or invest it into fixed interest bearing securities, (v) With the increase in international business operations of Indian Companies, Indian capital market is bound to extend its operations beyond the limits of the country, (vi) BSE and NSE are the base of Indian Capital market and they have lion share in security market operations. They should be allowed in the same manner with greater autonomy and latest technology which will help the investors a lot and Indian capital market could be developed at the desired pace.

On the basis of above discussion, it may be concluded that financial sector reforms have carried positive impact on the Indian Capital market. Indian Capital market is on the path of development and trying to touch the international standards. Development is a continuous process that is why reforms process is expected to continue until full objectives are achieved.

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