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FINANCIAL MARKET IN INDIA: AN ANALYSIS

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ABSTRACT

The pace of economic development is the rate of long term investment and capital formation. Financial reform in 1999 , is requirement of economic reform of 1991,and financial analysis helps to study the development in economy, in terms of stability in inflation ,increase in growth and development by developing the money and capital market. The stock exchange or security exchange board of India shows the transaction and trade of securities . A stock exchange is a form of exchange, which provides services for stockbrokers and traders to trade shares, debentures and other securities. Stock exchanges also provide facilities for issue and redemption of securities , to be able to trade a security on a certain stock. Present day capital markets are constantly facilitated on PC based electronic exchanging stages; most can be gotten to just by substances inside the money related division or the treasury branches of governments and partnerships. Capital formation is conditioned by the mobilisation augmentation and channelisation of investible funds. The capital market serves a very useful purpose by pooling the capital resources of the country and making them available to the enterprising investors. Well-developed capital markets augment resources by attracting and lending funds on a Global Scale .

Key Words :Capital, Development, Mobilisation , Money.

INTRODUCTION

1. Financial Market

a. Capital Market-Long Run Market

There are broadly two types of financial markets in an economy:

(i)Money Market -Money Market deals in short term funds.

The focus remain on analysis of long term financial market that is capital market .

(ii) Capital Market- Capital Market is the aggregation of buyers and sellers of stocks and deals in long term loanable funds. Capital Market funds are used by industry and trade for making fixed investments . The main participants in the market are mutual funds, insurance companies, development banking institutions, foreign institutional investors, corporate organizations as well as individuals .

1. The significance of capital market is in mobilizing funds and resources needed for development .
2. The implementation of the policies relating to stabilization , monetary controls and regulation of the banking system .

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FUNCTIONS :

1.Capital Markets is to provide ease of transactions for both the investors and the companies.
2.Both parties should be able to find each other with ease and the legal aspect of things should go smoothly.
3.A capital market is a money related market in which long haul obligation (over a year) or value sponsored protections are purchased and sold.
4.Capital markets channel the abundance of savers to the individuals who can put it to long haul gainful use, for example, organizations or governments making long haul investments.
5. Financial controllers like the Bank of England (BoE) and the U.S. Protections and Exchange Commission (SEC) supervise capital markets to ensure speculators against extortion, among different obligations (I)

NATURE OF MARKET

(a).Essential market – (i)In essential market, new stock or security issues are offered to financial specialists, frequently by means of a system known as endorsing.
(ii).The fundamental substances looking to raise long haul assets on the essential capital markets are governments (which might be city, nearby or national) and business undertakings (organizations).
(iii)Governments issue just bonds, while organizations frequently issue both value and bonds. The fundamental substances acquiring the securities or stock incorporate benefits reserves , mutual funds , sovereign riches reserves , and less normally well off people and speculation banks exchanging without anyone else sake. In the optional market, existing protections are sold and purchased among speculators or dealers, generally on a trade, over-the-counter, or somewhere else.
(b)Auxiliary market - The presence of auxiliary markets expands the ability of financial specialists in essential markets, they are probably going to have the option to quickly money out their speculations if the need emerges.

OBJECTIVES

1. Capital Formation- Savings making available to companies and public authorities .
2. It encourages saving in financial form through assets with attractive yields, liquidity and risk characteristics
3. Through the stock exchange, this market gives the opportunity to convert their holding into cash. It also offers companies which have securities the opportunity to obtain cash without reducing their liquidity.
4. The capital market offers access to a variety of financial instruments that enable economic agents to pool, price and exchange risk.

OBJECTIVES OF CAPITAL MARKET REGULATION

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(a)Prime Objective ,

(I)Regulation is investor protection, creative accounting, insider dealings and misuse of client money are some of the vices that investors needs to be protected from.

(b)Core Objectives

(i) Protection of investors

(ii) Ensuring that the markets are fair, efficient and transparent.

(iii) The reduction of systemic risk .

HISTORY

a. The capital market in India dates back to the eighteenth century when East India Company securities were traded in the country. Until the end of the nineteenth century securities trading was unorganized and the main trading centers were Bombay (now Mumbai) and Calcutta (now Kolkata). Bombay was the chief trading center . The Bombay Stock Exchange was recognized in May 1927 under the Bombay Securities Contracts Control Act, 1925.

b. (i) The size of the capital market remained small , in the post independence period . (ii) The government's emphasis on the development of the agricultural sector and public sector undertakings , during the first and second five year plans. (iii)The public sector undertakings were healthier than the private undertakings in terms of paid up capital but shares were not listed on the stock exchanges. (iv) The Controller of Capital Issues (CI) supervised and controlled the timing, composition, interest rates pricing allotment and floatation consist of new issues. (v)These strict regulations de-motivated many companies from going public for almost four and a half decades .

INSTRUMENTS

(a) Debt Instruments - used by either companies or governments to generate funds for capital-intensive projects . It can obtained either through the primary or secondary market. The relationship in this form of instrument ownership is that of a borrower – creditor and thus, does not necessarily imply ownership in the business of the borrower. The contract is for a specific duration and interest is paid at specified periods as stated in the trust deed (contract agreement) . The principal sum invested, is therefore repaid at the expiration of the contract period with interest either paid quarterly, semi-annually or annually. The interest stated in the trust deed may be either fixed or flexible. The tenure of this category ranges from 3 to 25 years. Investment in this instrument is, most times, risk-free and therefore yields lower returns when compared to other instruments traded in the capital market. Investors in this category get top priority in the event of liquidation of a company.

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When the instrument is issued by,
(i) The Federal Government, known as Sovereign Bond.
(ii) A state government , known as State Bond.
(iii) A local government, known as Municipal Bond.
(iv) A corporate body (Company), known as Debenture, Industrial Loan or Corporate Bond.

(b) Equities (also called Common Stock)- issued by companies only and can also be obtained either in the primary market or the secondary market. The investor possesses certain rights and privileges (such as to vote and hold position) in the company. The investor in debts may be entitled to interest must be paid , the equity holder receives dividends which may or may not be declared . The risk factor in this instrument is high and yields a higher return (when successful). Holders of this instrument rank bottom on the scale of preference in the event of liquidation of a company .

(c) Preference Shares- issued by corporate bodies and the investors rank second (after bond holders) on the scale of preference . The instrument possesses the characteristics of equity in the sense that when the authorised share capital and paid up capital are being calculated, they are added to equity capital to arrive at the total. Preference shares can also be treated as a debt instrument as they do not confer voting rights on its holders and have a dividend payment that is structured like interest (coupon) paid for bonds issues .
Preference shares may be:
(i)Irredeemable, convertible: in this case, upon maturity of the instrument, the principal sum being returned to the investor is converted to equities even though dividends (interest) had earlier been paid.
(ii)Irredeemable, non-convertible: here, the holder can only sell his holding in the secondary market as the contract will always be rolled over upon maturity. The instrument will also not be converted to equities.
(iii)Redeemable: here the principal sum is repaid at the end of a specified period. In this case it is treated strictly as a debt instrument. Interest may be cumulative, flexible or fixed depending on the agreement in the Trust Deed.

(d) Derivatives
These are instruments that derive from other securities, which are referred to as underlying assets (the derivative is derived from them). The price, riskiness and function of the derivative depend on the underlying assets since whatever affects the underlying asset must affect the derivative. The derivative might be an asset, index or even situation. Derivatives are mostly common in developed economies.
The derivatives are: Mortgage-Backed Securities (MBS),Asset-Backed Securities (ABS), Futures, Options, Swaps ,Rights, Exchange Traded Funds or commodities .

ADVANTAGES AND DISADVANTAGE OF CAPITAL MARKET

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(a)Advantage
(i)No fixed cost for the enterprise_ dividends do not have to be paid on a specific date and anymore than the principal matures at a specified moment . The cost only appears if the company makes a profit , in the form of profit distribution.
(ii)No maturity term investment in shares are the investment in permanent capital that cannot be withdrawn and whose return from the company cannot be requested.
(iii)Improves the credit rating by issuing shares a company acquires new, fresh, permanent capital that strengthens its business position, make it stable. As new capital enters in the company, its leverage improves and debt indicators decrease , through improving its credit rating and opening up new possibilities for financing through debt instruments.
(iv) Easier sale a good and stable company can sell shares more easily than bonds, since the market is wider. A well developed secondary market opens up possibilities for investors to acquire both dividends and capital gain and to liquidate their capital fast through the financial market.
(v)Higher yield due to greater risk of investing in shares , investors obtain a higher yield which is ,however , less favorable from the issuer's viewpoint , as they have higher financing costs .

(b)Disadvantage
(i)Dilution -- There is no dilution with bonds , but there is with shares . If a company opt for financing by share issue, their number will increase , there by increasing the amount of capital and existing owner's percentage ownership.
(ii)More expensive source of financing . The considerably higher risk faced by investors in the ownership instrumental is an obligation to pay higher compensation.
(iii) Risk of loss_ although there are many advantages for the investors, as well as possibility of higher profits , investing in ownership instruments carries a loss of risk.
(iv)Unknown obligation-_The paid dividend is based on business performance and the investor does not know when and how much they will get profit from a given share , while the issuer also does not necessarily have full control over payment of profit to shareholders .
(v)Unfavourable tax treatment - This way of financing lacks tax incentives. The dividend is paid out of net profit after taxes and thus it is not a tax shelter from profit tax. Investors also have to pay tax when profits are transferred to their accounts.

PRIMARY MARKET

The most important type of capital market is the Primary Market or New Issue Market and deals with the issue of new securities, i.e. securities that are issued to investors for the very first time.
Function : Capital formation for the companies, governments, institutions , helps investors invest their savings and extra funds in companies starting new projects or enterprises looking to expand their companies.
Institutional Structure

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1. Origination

Origination refers to the preliminary work relating to the assessment and formulation of new proposals for setting up a new unit, expanding an existing unit or for diversification of the existing business, a firm conducts technical, economic, financial, marketing and legal analysis of the new project and decides the magnitude and pattern of financing .

2. Underwriting

Underwriting is an important function and eliminates uncertainty with regard to the public response to a new issue of securities (equity shares, debentures, bonds, etc.). When the public does not fully subscribe to an issue, the balance is taken up by the underwriters . According to the underwriting function , an issuing company is ensured that the required amount will be raised in the market. The underwriter charges an underwriting commission for the service and might end up having a shareholding in the company.

3. Distribution

The securities have to be sold in the public , requires an effective marketing strategy covering advertising, distribution and personal selling functions are performed by a wide network of brokers, dealers and agents. The success of the marketing effort greatly depends upon the investors' perception of the company's present performance, future prospects, strengths and weaknesses and opportunities and threats . The expected risk and return factors are of critical importance behind an investor's decision.

ISSUE MECHANISM

(a)Offer through Prospectus

This is a method of public issue and the most used method in the primary market to raise funds . Company invites the investors (general members of the public) to invest in their company via an advertisement also known as a prospectus.

When a prospectus is issued, the public subscribes to shares, debentures etc. and the response, shares are allotted to the public. If the subscriptions are very high, allotment will be done on lottery or pro-rata basis. The company can sell the shares directly to the public, but it generally hires brokers and underwriters. Merchant banks are another option to help out with the process, especially Initial Public Offerings.

(b) Private Placement

Public offers are an expensive affair. The incidental costs of IPO's tend to be very high. They offer investment opportunities to a select few individuals and the company will sell its shares to financial institutes, banks, insurance companies and some select individuals. It helps them raise the funds efficiently, quickly and economically. Such companies do not sell or offer their securities to the public at large.

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When a company is looking to expand or are in need of additional funds, they first turn to their current investors . The current shareholders are given an opportunity to further invest in the company. They are given the "right" to buy new shares before the public is offered the chance . This allotment of new shares is

done on pro-rata basis. If the shareholder chooses to execute his right and buy the shares, he will be allotted the new shares. However, if the shareholder chooses to let go of his rights issue, then these shares can be offered to the public.

(c) e-IPO

It is Electronic Initial Public Offer. When a company wants to offer its shares to the public it can now also do so online. An agreement is signed between the company and the relevant stock exchange known as the e-IPO. This system introduced in India three years ago by the SEBI and makes the process of the IPO speedy and efficient. The company hire brokers to accept the applications received and a registrar to the issue.

(A)Advantages

(i) Companies get to raise capital at low costs and mobilize savings.

(ii) Securities issued in the primary market can be sold immediately in the secondary market. This means high liquidity.

(iii) An excellent method of diversification to reduce risk.

(iv) Price manipulation is low compared to secondary markets.

(v) There is no brokerage, transaction fees and stamp duty.

(v) There are no market fluctuations in the primary market.

(vii) A good approach of FDI (Foreign Direct Investment).

(viii) Capital can be raised through the sale of treasury bonds.

(B) Disadvantages

(i) In case of oversubscription, small investors don’t get an allocation.

(ii) Money gets locked in for a long time.

10.Secondary Market (Capital Market)

Commonly known as the stock market or the stock exchange and the securities (shares, debentures, bonds, bills etc) are bought and sold by the investors . In the primary market only new securities issued, whereas in the secondary market the trading is for already existing securities. There is no fresh issue in the secondary market. The securities are traded in a highly regularised and legalized market within strict rules and regulations. It ensures that the investors can trade without the fear of being cheated. In the last decade or so due to the advancement of technology. Its main role is to provide liquidity to the securities, a function through which it plays an indirect role in encouraging the primary market and corporate financing. It is the index of the state of the industrial economy and an important indicator of overall business environment.

Components

1. Stock Exchanges :An organised segment of the market and deal with the securities of corporate organizations , listed on stock exchange .

2. Over-the-counter Market

Where the securities of the smaller companies are traded on the basis of direct negotiations between brokers.

Advantages

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1. Mobilizes savings and encourages investors to invest money in the form of shares. Secondary market provide a platform for easy trading in shares, which helps convert shares to cash.
2. Shareholders enjoy a great opportunity to save and invest and capital appreciation as share value increases, also an opportunity to get dividends on shares .
3. There are stockbrokers and investment advisors , offer investment advice in secondary markets and buy/sell shares and you don't need to be an expert on stocks.
4. Managers are custodians of the company, shareholders are the owners . The managers is accountable to the shareholders of the company. Management of listed companies is always better than the unlisted, as shareholders keep a close eye on the management of the company.

Disadvantages

1. Secondary markets are volatile. Investments in stocks are risky. Shares go up and down many times a day, returns or lose a lot of money.
2. When you buy/sell shares, brokers earn commission, eating up profits.
3. The process of investing in secondary markets may be time consuming.

CONCLUSION

The expanion in the size of the industrial units and business corporations due to technological developments, economies of scale and other factors has created a situation where, the capital at the disposal of one or few individuals is quite insufficient to meet the growing investment demands. A developed capital market helps for paucity of funds. An organised capital market can mobilise and pool together even the small and scattered savings and augment the availability of investible funds. The rapid growth of joint stock companies possible to a large extent the growth of capital markets , the growth of joint stock business in its turn , encouraged the development of capital markets . A developed capital market provides a number of investment opportunities for the small savers. The equity sale gives a company access to capital and investors ownership in a company with the gains based on the future performance of the company.

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