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A STUDY ON GROWTH OF FINANCIAL MARKETS IN INDIA

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ABSTRACT

The objective of this paper is to analyse the functioning and growth of Indian financial markets. The analysis has been done using secondary data taken from the Reserve bank of India and National Stock Exchange. The money market, capital market, primary market and secondary markets have been discussed in detail with respect to their functioning and growth. Analysis of the data from the year 2000 to 2013 reveals that financial markets have shown a tremendous growth in past thirteen years. However, there is a lot more scope of improvement in the system. The markets need be to more efficient and competitive for fast growth of the economy.

KEYWORDS: Capital Market, Financial Markets, Money Market

INTRODUCTION

Business operates in a financial system, which facilitates the smooth running and development of the business. Businesses need funds for operations and growth. The financial system brings the savers and demanders of funds together. The savers are the individuals, businesses and government who have surplus money to invest. And the demanders are also the individual, businesses and government who require money for various purposes. An individual can be a saver and demander both at the same time. For example, one invests his/her monthly savings in a bank account and simultaneously has taken a loan for his/her house. The bank provides lump sum money for buying the house and accepts instalments at later dates against the loan. So it can be understood that the bank fills the gap between and timings of requirement and availability of funds of the individual. A bank is an intermediary in the financial system.

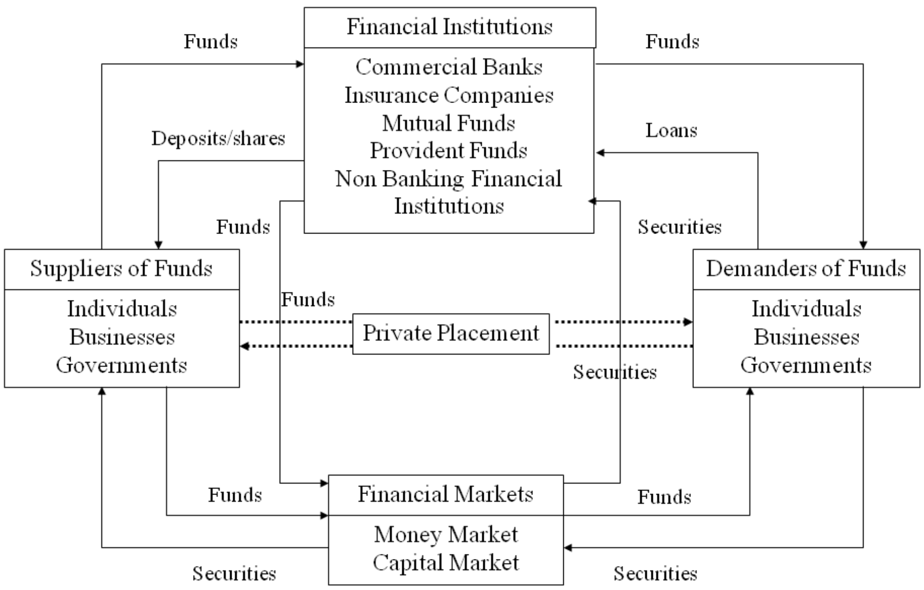

Figure 1: Financial System

Financial system is constituted of financial markets, financial institutions and financial instruments. Figure 1 explains the financial system in detail. Financial institutions and financial markets play as intermediary between the savers and demanders of funds. The funds can be directly transferred from savers to the industry without the intervention of intermediaries and markets, such direct transfer of funds is called private placement. Funds can also be transferred through financial institutions like, commercial banks, mutual funds insurance companies etc. The financial institutions play intermediary to channelize the funds from the savers to the demanders. Financial markets provide marketability and liquidity to the financial instruments. The financial markets play a very important role in the growth of a country. A well developed financial market helps attract good quality investment from foreign countries and facilitates efficient distribution of the capital for overall growth of the country. Based on literature on the role of financial systems in enhancing enterprise value, this paper analyses the performance of Indian financial markets and their growth in the last ten years.

FINANCIAL MARKETS

A financial market is a market where financial instruments are exchanged (i.e., traded) (Fabozzi 2002). It facilitates the sale and resale of transferable securities like equity, debt, government securities, derivatives etc. Although the existence of a market is not a necessary condition for exchange of a financial asset, an asset can be exchanged on a private basis from one person to other, but a financial market provides an opportunity to access to a wider investor base. The markets can be classified into various categories on the following bases:

On the Basis of Maturity Period of Securities

Capital Market

Capital market is a market for long term securities i.e. the securities which have maturity period greater than one year for example, Equity shares and Debentures. The capital market aids economic growth by mobilising the savings of the economic sectors and directing the same towards channels of productive use. Equity shares and long term debentures are primary instruments for raising long term funds by the companies. The companies may raise funds not only from the domestic market but also from the foreign markets in the form of equity through the issue of Global Depository Receipts (GDR) and American Depository Receipts (ADR) and in the form of debt through External Commercial Borrowings (ECB) and Foreign Currency Convertible Bonds (FCCB).

Foreign investors can invest in Indian companies by investing their money in Indian capital markets directly through Foreign Direct Investments (FDI) and Foreign Institutional Investments (FII). FII is mainly a portfolio investment where the intention is short term investment. That's why FII is also called Hot Money. Both GDR and FDI are investments in equity of a company but the major difference is that GDRs are the shares of Indian company issued in foreign country and listed in the foreign country whereas FDI is investment in shares of Indian company floating in India and listed in India.

Table 1: Foreign Investment Inflows

Year	Net Foreign Direct Investment	Net Portfolio Investment
	Rupees Billion	Rupees Billion
2000-01	149.24	118.20
2001-02	226.30	92.90
2002-03	155.94	45.04
2003-04	109.44	518.98
2004-05	167.45	413.12
2005-06	134.25	553.57
2006-07	349.10	318.81
2007-08	637.76	1106.19
2008-09	1000.00	-651.00
2009-10	858.00	1540.00
2010-11	541.00	1394.00
2011-12	1021.37	851.26
2012-13	1078.60	1465.59

Table 2: Top Five Investing Countries in FDI in India

Rank	Country	Inflows (Rs Crore)
1	Mauritius	247,092
2	Singapore	58,090
3	United States	42,898
4	United Kingdom	29,451
5	Netherlands	25,799

Source: Compiled from data taken from official website of Reserve bank of India www.rbi.org.in

Table 1 indicates the foreign investment inflows in India from the year 2000 to 2013. Since 2001 the inflow of FDI has increased 6.2 times in year 2013 and inflow of FII has increased 11.39 times in 2013. From 2006 to 2013 India has attracted huge investments in both FDI and FII. Moreover opening up of multi brand retail would further increase the FDI inflow in India. FDI investment is considered to be good for growth of the country because it bring expertise and technology with it. Table 2 shows the share of top five investing countries in FDI in India from 1991 to 2004. Mauritius has been the largest investor of FDI in India. India has a Double Taxation Avoidance Treaty with Mauritius, under which the corporate registered there can choose to pay taxes in the island nation. Companies prefer to route their investment through the famous Mauritius route because of as low as three per cent effective rate of corporate tax on the foreign companies incorporated there.

Table 3: Commercial Paper- Total outstanding as of March

Year	Amount (Rs Crore)	Range of Discount (Percent)
2008-09	44171	6.40-12.50
2009-10	76056	5.30-9.00
2010-11	80305	7.93-15.00
2011-12	181770	8.36-14.60*
2012-13	199840	7.97 – 13.37*
2013-14	164170	7.99 – 12.50*
***The amount is as on 31st January of the year**		

Source: *Compiled from data taken from official website of Reserve bank of India* www.rbi.org.in

Table 4: Certificates of Deposit - Total Outstanding as of March

Year	Amount (Rs Crore)	Rate of Interest (Percent)
2008-09	192867	6.00-11.50
2009-10	341054	4.52-7.12
2010-11	424740	9.00-10.60
2011-12	423767	9.02-10.50*
2012-13	390940	9.50-10.07*
2013-14	338290	8.11-9.25*
*The amount is as on 31st January of the year		

Source: *Compiled from data taken from official website of Reserve bank of India* www.rbi.org.in

Money Market

The money market is a place for large institutions and government to manage their short-term cash needs. Money market securities are highly liquid and extraordinarily safe, short term debt securities issued by government, financial institutions and large corporations. Because they are extremely conservative, money market securities offer significantly lower returns than most other securities. Individual investors have little access to money market securities because the securities are traded in very high denominations. Furthermore, the money market is not a physical market but the transactions are done over the telephone or through electronic systems. The easiest way for an individual to gain access to the money market is with a money market mutual fund, or sometimes through a money market bank account. These accounts and funds pool together the assets of thousands of investors in order to buy the money market securities on their behalf. However, some money market instruments, like Treasury bills, may be purchased directly. There are several different instruments in the money market, offering different returns and different risks. For example- Call money, commercial papers, certificates of deposit, treasury bills etc. Call money market is an interbank market for very short term money requirements. Commercial papers are unsecured promissory notes issued by highly rated corporate. Certificates of deposit are issued by the Commercial banks for their short term money requirements. Certificates of deposits are different from Bank Fixed deposits in term of their negotiability. CDs are negotiable while FDs are non-negotiable. Thus CDs can be traded in secondary market and have better liquidity than FDs. Treasury bills are instruments of Government for raising short term finance. T-bills are issued by the Reserve Bank of India on behalf of the government.

Table 3 shows the total out-standings and range of discount rate of commercial papers issued by corporate from 2008-09 to 2013-14. Table 4 shows the total out-standings and interest rates of certificates of deposit issued by commercial banks from 2008-09 to 2013-14.

On the Basis of Issue of Securities

Primary Market

Table 5: Public Offerings in India

Year	Number of Public Offerings
2013	27
2012	46
2011	40
2010	73
2009	21
2008	36

Table 5: Contd.,

2007	95
2006	73
2005	50
2004	19
2003	5
2002	2
2001	2
2000	11

Source: The official website of National Stock Exchange www.nseindia.com

It is a market for new issues of securities. Companies, governments or public sector institutions can raise funds through the sale of a new stock or bond issue. In a primary issue, the securities are issued by the company directly to investors. The company receives the money and issues new security certificates to the investors. Primary issues are used by companies for the purpose of setting up new business or for expanding or modernizing the existing business. The primary market performs the crucial function facilitating capital formation in the economy.

Table 6: Indicators of National Stock Exchange

Year	No. of Companies Listed	Turnover (Rs.crore)	Market Capitalisation (Rs. Crore)
2010-2011	1,574	35,77,412	67,02,616
2009-2010	1,470	41,38,024	60,09,173
2008-2009	1,432	27,52,023	28,96,194
2007-2008	1,381	35,51,038	48,58,122
2006-2007	1,228	19,45,285	33,67,350
2005-2006	1,069	15,69,556	28,13,201
2004-2005	970	11,40,071	15,85,585
2003-2004	909	10,99,535	11,20,976
2002-2003	818	6,17,989	5,37,133
2001-2002	793	5,13,167	6,36,861
2000-2001	785	13,39,510	6,57,847

Source: Official website of National Stock Exchange www.nseindia.com

The new shares can be issued either through prospectus, rights issue or private placement. Issue through prospectus is called an initial public offering (IPO). This is typically done through investment bankers. The direct sale of securities by a company to some select people or to institutional investors is called private placement. In case of rights issue the new shares are issued to existing shareholders. IPOs are often issued by smaller, younger companies seeking the capital to expand, but can also be done by large privately owned companies looking to become publicly traded. In an IPO, the issuer obtains the assistance of an underwriting firm, which helps it determine what type of security to issue (common or preferred), the best offering price and the time to bring it to market.

The Table 5 shows the position of public offerings in India from the year 2000 to 2013. The number of public issues sharply increased after 2004 however it declined in 2008 and 2009 due to the economic recession.

Secondary Market

A market for secondary trading of securities already issued. Once the company issues securities in the primary market, the securities are bought and sold by the investors in secondary market. Stock exchanges are the secondary markets. A company has to list its securities on the exchange so that they are available for trading. The stock exchanges levy annual listing fees on the listed companies, this constitutes their major source of income. The trading is done online through electronic trading system.

If an investor wants to sell a security before its maturity, he can do so by selling it in the secondary market, the secondary market provides liquidity and marketability to the securities.

In a stock market there are large number of buyers and sellers of securities connected through trading terminals so the stock market is like a perfect market where the prices are determined on the basis of demand and supply. Thus stock market helps in discovering the true price of the securities.

Table 6 shows some important indicators of growth of the National Stock Exchange. The number of listed companies, turnover and market capitalisation have sharply increased in last eleven years.

GROWTH IN FINANCIAL MARKETS

With the initiation of reforms and the transition to indirect, market-based instruments of monetary policy in the 1990s, the Reserve Bank of India has made conscious efforts to develop an efficient, stable and liquid financial market by creating a favourable policy environment through appropriate institutional changes, instruments, technologies and market practices.

The money market is the key link in the transmission mechanism of monetary policy to financial markets and finally, to the real economy. In the past, development of the money market was hindered by a system of administered interest rates and lack of proper accounting and risk management systems. The reduction in bid-ask spread in the money market overnight rates indicates that the Indian money market has become reasonably deep, vibrant and liquid. Since 1991-92, the primary market has grown fast as a result of the removal of investment restrictions in the overall economy and a repeal of the restrictions imposed by the Capital Issues Control Act.

The functioning of the government securities market since the mid-1990s indicates consistent increase in its size in tandem with the growth in market borrowings of both the Central and the State Governments. Introduction of the auction based system has improved the price discovery process. Reflecting the effectiveness of various measures to develop the market, the turnover in the secondary market has increased manifold over the years. The establishment of settlement and trading infrastructure has also led to increased activity in the secondary market. Thus, the government securities market in India has witnessed a transition to an increasingly broad based market, characterised by an efficient auction process, an active secondary market and a liquid yield curve. These developments have aided the smooth financing of government debt, of both the central government and state governments, even when their fiscal deficits were high and rising.

As per the study conducted by IBM Institute for Business Value, “India's financial markets size has been estimated to race from under USD one trillion to 17 trillion by 2025 as globalisation led opportunities shift from veteran markets to emerging markets. However, India lacks some of the market sophistication like underdeveloped infrastructure and one of the highest ratios of public debt to GDP that can be a stumbling block which can hinder and halt further globalisation."

CONCLUSIONS

Indian financial markets have come a long way on the road of growth and development. But still there is a requirement of financial systems become more efficient and competitive. In an efficient financial system markets are competitive; information is accessible and widely distributed. To promote a positive relationship between financial system and economic growth, we need a stable macroeconomic framework. Unstable government finances and high inflation can destroy the financial system. The stable framework can be developed by developing a sound regulatory framework, privatization of financial institutions and removal of discriminatory taxes etc. Strong corporate governance and adoption of sound accounting practices are also important for development of efficient financial markets.

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