ISSN 2278-8808
SJIF 2015: 5.403
An International Peer Reviewed & Referred
SCHOLARLY RESEARCH JOURNAL FOR INTERDISCIPLINARY STUDIES

IMPORTANCE OF SECURITIES MARKET'S IN THE INTENSIFICATION OF INDIAN ECONOMY: A REVIEW

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Abstract

The financial markets (banks and the securities markets) finance economic growth. They channelize savings to investments and thereby de-couple these two activities. As a result, savers and investors are not constrained by their individual abilities, but by the economy's ability to invest and save respectively, which inevitably enhances savings and investment in the economy. To the extent the growth of an economy depends on the rate of savings and investment, financial markets promote economic growth. The banks and securities markets are two competing mechanisms to channel savings to investment. The securities markets score over banks in the allocation efficiency, as it allocates savings to those investments which have potential to yield higher returns. This inevitably leads to higher returns to savers on their savings and higher productivity on investments to enterprises. Hence to the extent economic growth depends on the rate of return on investments, securities market promotes economic growth.

INTRODUCTION

India which is second only to the United States in terms of number of listed companies, has a securities market which is remarkable for the sheer number of market participants, the number of listed securities and the volume of transactions. The National Stock Exchange of India Limited is the third largest exchange in the world in terms of the number of equity transactions, after the New York Stock Exchange and NASDAQ.

With the global economy picking up in recent times, key players in the Indian capital markets are innovating with new financial instruments and investment strategies. In recent years, Indian companies have listed themselves overseas on the AIM, the Singapore Exchange and the London Stock Exchange, and have used American Depository Receipts, Global Depository Receipts, convertible alternative reference securities, Foreign Currency Convertible Bonds and qualified institutional placements to raise funds in adverse market conditions. The use of these instruments and leveraged buyouts has helped some major Indian companies to acquire much larger multinational profiles. Aditya Birla Group's acquisition of Novelis Inc and the Columbian Chemicals Company, Tata Motors' acquisition of Jaguar and Land Rover, United Spirits' acquisition of Whyte & Mackay and Bharti Telecom's acquisition of Zain are cases in point.

The corporate sector has relied on a variety of non-bank funding sources such as capital markets, external commercial borrowings and internal generation of funds. In 2010, India ranked third only to Japan and China in equity capital market issuances among countries in Asia Pacific. Based on the data released by the Reserve Bank of India, the gross cumulative inflows by way of external commercial borrowings (ECBs) in the months from April 2010 to November 2010 totaled US$11.48 billion, higher than the level of the same in the corresponding period in 2009-10. However, the volume of foreign currency convertible bonds (FCCBs) declined to US$1.07 billion during April-November 2010. ECB flows of US$1.82 billion in October- November 2010 were higher than ECB inflow of US$1.66 billion in the corresponding period last year, supported by certain large issuances. Some of the large issuances of ECB/FCCB during the three month period of September-November 2010 include Reliance Industries (US$1 billion), REC (US$470 million), IRFC (US$350 million), Bhushan Steel (US$300 million), Jhajjar Power (US$288 million), Power Finance Corporation (US$240 million), Nissan Motor (US$156 million), Idea Cellular (USS$150 million), Posco Maharashtra Steel (US$143 million), L&T Sapura Shipping (US$ 141 million).

However, the move by the Reserve Bank of India to restrict access to ECBs has led to the mobilisation through commercial paper issuances by corporates to meet their working capital requirements. In 2010, about 53 companies raised about US$ 6226 million through sale of shares to qualified institutional investors, including overseas private equity firms and local and foreign financial services firms like banks, insurers and fund houses. However, during the calendar year 2009, the funds raised through the QIP route amounted to about US$ 7169 million. While there were no ADR issues in 2010, some action was seen in the area of fund-raising through GDRs. There were 33 GDR issuances, which raised US$879 million. This was almost 43 per cent lower than the funds raised through GDR issues in 2009.

Foreign institutional investor investments in the capital markets (which began in January 1993 with inflows of $1m) were approximately US$10.99 billion during the quarter ended December 31, 2010. With this the net equity FII inflows in the first nine months of 2010-2011 financial year stood at around US$24.81 billion, the highest in at least the last four financial years. In addition, venture capitalists invested $895 million in 92 deals in 2010, a 15% increase in deal activity and 14% increase in capital invested. Forty-one percent of capital went to Consumer Services companies, which collected $369 million for 29 deals. Investment in the Business & Financial Services industry was also strong as 28 deals garnered $282 million.

Securities regulation

The establishment of the Securities and Exchange Board of India in 1992 led to considerable growth in the capital markets and securities sector. SEBI serves as the autonomous statutory regulator of financial markets in India, and has as its twin objectives the protection of investors' interests and the development and regulation of the Indian securities markets. SEBI has powers to investigate and examine companies, to visit their premises, to inspect records and personnel and to impose penalties that are commensurate with any misconduct. SEBI regulates the markets through its rulemaking powers and has issued a number of regulations and guidelines relevant to the securities market and specifically related to corporate governance norms for listed companies. SEBI regulations, today cover all intermediaries in the securities market, all of whom must be registered with and regulated by SEBI. The regulations also prescribe a code of conduct for each intermediary as well as for their employees, and set out standards that stipulate who may be considered a fit and proper person.

The present capital market scenario features an advanced regulatory environment, steadily increasing market capitalisation, better allocation and mobilisation of resources, a rapidly developing derivatives market, a robust mutual fund industry and increased issuer transparency. SEBI has effectively brought in a strict investor protection regime and various market reforms. Capital adequacy and other norms have been specified and a system for monitoring and inspecting their operation has been instituted to enforce compliance. Disciplinary action is taken against rule breaches. All intermediaries in the market are obliged to have a compliance officer, who reports any observed non-compliance directly and independently to SEBI. Modified regulations that SEBI introduced have enabled Indian companies to raise finances both domestically and internationally.

Functions of Securities Market

The securities market allows people to do more with their savings than they would otherwise. It also allows people to do more with their ideas and talents than would otherwise be possible. The people's savings are matched with the best ideas and talents in the economy. Stated formally, the securities market provides a linkage between the savings and the preferred investment across the entities, time and space. It mobilizes savings and channelises them through securities into preferred enterprises.

The securities market enables all individuals, irrespective of their means, to share the increased wealth provided by competitive enterprises. The securities market allows individuals who can not carry an activity in its entirety within their resources to invest whatever is individually possible and preferred in that activity carried on by an enterprise. Conversely, individuals who can not begin an enterprise they like can attract enough investment form others to make a start and continue to progress and prosper. In either case, individuals who contribute to the investment share the fruits.

The securities market also provides a market place for purchase and sale of securities and thereby ensures transferability of securities, which is the basis for the joint stock enterprise system. The liquidity available to investors does not inconvenience the enterprises that originally issued the securities to raise funds. The existence of the securities market makes it possible to satisfy simultaneously the needs of the enterprises for capital and of investors for liquidity.

The liquidity the market confers and the yield promised or anticipated on security encourages people to make additional savings out of current income. In the absence of the securities market, the additional savings would have been consumed otherwise. Thus the provision of securities market results in net savings. The securities market enables a person to allocate his savings among a number of investments. This helps him to diversify risks among many enterprises, which increases the likelihood of long term overall gains.

Securities Market and Economic Growth

A well functioning securities market is conducive to sustained economic growth. There have a number of studies, starting from World Bank and IMF to various scholars, which have established robust relationship not only one way, but also the both ways, between the development in the securities market and the economic growth. An important study by Ross Levine and Sara Zervos (1996) finds that the stock market development is highly significant statistically in forecasting future growth of per capita GDP. Their regressions forecast that if Mexico or Brazil were to obtain stock markets as advanced as Malaysia, then they might obtain an additional per capita GDP growth per year of 1.6%. This happens, as market gets disciplined / developed/ efficient, it avoids the allocation of scarce savings to low yielding enterprises and forces the enterprises to focus on their performance which is being continuously evaluated through share prices in the market and which faces the threat of takeover. Thus securities market converts a given stock of investible resources to a larger flow of goods and services.

The securities market fosters economic growth to the extent that it-augments the quantities of real savings and capital formation from any given level of national income, increases net capital inflow from abroad raises the productivity of investment by improving allocation of investible funds, and reduces the cost of capital. It is reasonable to expect savings and capital accumulation and formation to respond favourably to developments in securities market. The provision of even simple securities decouples individual acts of saving from those of investment over both time and space and thus allows savings to occur without the need for a concomitant act of investment. If economic units rely entirely on self-finance, investment is constrained in two ways: by the ability and willingness of any unit to save, and by its ability and willingness to invest. The unequal distribution of entrepreneurial talents and risk taking proclivities in any economy means that at one extreme there are some whose investment plans may be frustrated for want of enough savings, while at the other end, there are those who do not need to consume all their incomes but who are too inert to save or too cautious to invest the surplus productively. For the economy as a whole, productive investment may thus fall short of its potential level. In these circumstances, the securities market provides a bridge between ultimate savers and ultimate investors and creates the opportunity to put the savings of the cautious at the disposal of the enterprising, thus promising to raise the total level of investment and hence of growth. The indivisibility or lumpiness of many potentially profitable but large investments reinforces this argument. These are commonly beyond the financing capacity of any single economic unit but may be supported if the investor can gather and combine the savings of many. Moreover, the availability of yield bearing securities makes present consumption more expensive relative to future consumption and, therefore, people might be induced to consume less today. The composition of savings may also change with fewer saving being held in the form of idle money or unproductive durable assets, simply because more divisible and liquid assets are available.

The securities market facilitates the internationalisation of an economy by linking it with the rest of the world. This linkage assists through the inflow of capital in the form of portfolio investment. Moreover, a strong domestic stock market performance forms the basis for well performing domestic corporate to raise capital in the international market. This implies that the domestic economy is opened up to international competitive pressures, which help to raise efficiency. It is also very likely that existence of a domestic securities market will deter capital outflow by providing attractive investment opportunities within domestic economy. Any financial development that causes investment alternatives to be compared with one another produces allocational improvement over a system of segregated investment opportunities. The benefits of improved investment allocation is such that Mc Kinnon defines economic development as reduction of the great dispersion in social rate of return to existing and new investments under domestic entrepreneurial control. Instead of emphasising scarcity of capital, he focuses on the extra-ordinary distortions commonly found in the domestic securities markets of the developing countries. The distortions in the real sectors such as monopoly power, tariff protection, import quotas, credit rationing and so forth add salt to injury. In the face of great discrepancies in rate of return, the accumulation of capital does not contribute much to development. A developed securities market successfully monitors the efficiency with which the existing capital stock is deployed and thereby significantly increases the average return.

In as much as the securities market enlarges the financial sector, promoting additional and more sophisticated financing, it increases opportunities for specialisation, division of labour and reductions in costs in financial activities. The securities market and its institutions help the user in many ways to reduce the cost of capital. They provide a convenient market place to which investors and issuers of securities go and thereby avoid the need to search a suitable counterpart. The market provides standaridised products and thereby cuts the information costs associated with individual instruments. The market institutions specialise and operate on large scale which cuts costs through the use of tested procedures and routines.

There are also other developmental benefits associated with the existence of a securities market. First, the securities market provides a fast-rate breeding ground for the skills and judgement needed for entrepreneurship, risk bearing, portfolio selection and management. Second, an active securities market serves as an 'engine' of general financial development and may, in particular, accelerate the integration of informal financial systems with the institutional financial sector. Securities directly displace traditional assets such as gold and stocks of produce or, indirectly, may provide portfolio assets for unit trusts, pension funds and similar FIs that raise savings from the traditional sector. Third, the existence of securities market enhances the scope, and provides institutional mechanisms, for the operation of monetary and financial policy.

While the above indicate that the securities market promotes economic growth, it is not one way relation. The economic growth also promotes securities market.

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