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A Study on Impact of Financial Sector Reforms in India with Reference to Indian Capital Market

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Abstract

India's financial system comprising its banks, equity markets, bond markets, and myriad other financial institutions is a crucial determinant of the country's economic growth trajectory. Financial sector reforms in India introduced as a part of the structural adjustment and economic reforms programme in the early 1990s have had a profound impact on the functioning of all above said financial institutions. The principal objective of financial sector reforms was to improve the allocative efficiency of resources, ensure financial stability and maintain confidence in the financial system by enhancing its soundness and efficiency. The paper is presenting financial sector reforms in India, identify the emerging issues and explore the impact of reform in particularly capital market.

Key Words: financial forms, capital market, economic growth

Introduction

The stock exchanges in the country are in the process of adopting the best practices all over the world. The RBI has also been able to control and regulate effectively the operations and growth of the Non-Banking Financial Companies (NBFCs) in the country. A few changes which are on the anvil pertain to the legal provisions relating to fiscal and budget management, public debt, deposits, insurance etc. As per the Finance Minister, future reforms by making legal changes also pertain to banking regulations, Companies Act, Income Tax, Bankruptcy, negotiable instruments etc. But there are certain issues that call for more cautious approach towards the financial sector reforms in the future. The social sector indicators—like availability of doctor per 1000 population, availability of health institutions, quality of elementary education, literacy rate, particularly among the females—are some of the areas of serious concern. Countries like China, Indonesia and even Sri Lanka are much better than India in most of the social sector indicators.

The Indian capital market since early 1990s has undergone more than a decade of reforms on the road to improve transparency in the system, efficiency in information dissemination along with auditing disproportionate trade activities, the end purpose of all these reforms have been to en route the Indian market to such a level where it would fully integrate with the global developed exchanges. In the course country's capital market saw a major makeover and structural change in the mechanism. Along with the establishment of Securities and Exchange Board of India (SEBI) for providing higher level accountability in the market, new institutions like National Stock Exchange of India Limited (NSE), National Securities Clearing Corporation Limited (NSCCL), National Securities Depository (NSDL) have been the transformation operatives that abetted ordering the system which also tendered surety to investing public voluminously. Likewise, with expedients of latest technology suitable these institutions acted as determinations along with yardstick for others to pursue. As a result several changes taken place in the operations of the secondary markets namely, automated online trading in exchanges, enabling trading terminals of the NSE and Bombay Stock Exchange (BSE) to be available across the country making geographical location of an exchange irrelevant.

Reforms & Developments in Capital Market Since 1991

The government has taken several measures to develop capital market in post-reform period, with which the capital market reached new heights. Some of the important measures are

Securities and Exchange Board of India (SEBI)

SEBI became operational since 1992. It was set with necessary powers to regulate the activities connected with marketing of securities and investments in the stock exchanges, merchant banking, portfolio management, stock brokers and others in India. The objective of SEBI is to protect the interest of investors in primary and secondary stock markets in the country.

National Stock Exchange (NSE)

The setting up to NSE is a landmark in Indian capital markets. At present, NSE is the largest stock market in the country. Trading on NSE can be done throughout the country through the network of satellite terminals. NSE has introduced inter-regional clearing facilities.

Dematerialization of Shares

Demat of shares has been introduced in all the shares traded on the secondary stock markets as well as those issued to the public in the primary markets. Even bonds and debentures are allowed in demat form. The advantage of demat trade is that it involves paperless trading.

Screen Based Trading

The Indian stock exchanges were modernized in 90s, with Computerized Screen Based Trading System (SBTS), It cuts down time, cost, risk of error and fraud and there by leads to improved operational efficiency. The trading system also provides complete online market information through various inquiry facilities.

Investor Protection

The Central Government notified the establishment of Investor Education and Protection Fund (IEPF) with effect from 1st Oct. 2001: The IEPF shall be credited with amounts in unpaid dividend accounts of companies, application moneys received by companies for allotment of any securities and due for refund, matured deposits and debentures with companies and interest accrued there on, if they have remained unclaimed and unpaid for a period of seven years from the due date of payment. The IEPF will be utilized for promotion of awareness amongst investors and protection of their interests.

Rolling Settlement

Rolling settlement is an important measure to enhance the efficiency and integrity of the securities market. Under rolling settlement all trades executed on a trading day (T) are settled after certain days (N). This is called T + N rolling settlement. Since April 1, 2002 trades are settled' under T + 3 rolling settlement. In April 2003, the trading cycle has been reduced to T + 2 days. The shortening of trading cycle has reduced undue speculation on stock markets. ?

The Clearing Corporation Of India Limited (CCIL)

The CCIL was registered in 2001, under the Companies Act, 1956 with the State Bank of India as the Chief Promoter. The CCIL clears all transactions in government securities and repos and also Rupee / US $ forex spot and forward deals All trades in government securities below Rs. 20 crores would be mandatorily settled through CCIL, white those above Rs. 20 crores would have the option for settlement through the RBI or CCIL.

The National Securities Clearing Corporation Limited (NSCL)

The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

Trading In Central Government Securities

In order to encourage wider participation of all classes of investors, Including retail investors, across the country, trading in government securities has been introduced from January 2003. Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities.

Credit Rating Agencies

Various credit rating agencies such as Credit Rating Information services of India Ltd. (CRISIL – 1988), Investment Information and credit Rating Agency of India Ltd. (ICRA – 1991), etc. were set up to meet the emerging needs of capital market. They also help merchant bankers, brokers, regulatory authorities, etc. in discharging their functions related to debt issues.

Accessing Global Funds Market

Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Further Indian financial system is opened up for investments of foreign funds through Non-Resident Indians (NRIs), Foreign Institutional investors (FIls), and Overseas Corporate Bodies (OCBs).

Mutual Funds

Mutual Funds are an important avenue through which households participate in the securities market. As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

Internet Trading

Trading on stock exchanges is allowed through internet, investors can place orders with registered stock brokers through internet. This enables the stock brokers to execute the orders at a greater pace.

Buy Back Of Shares

Since 1999, companies are allowed to buy back of shares. Through buy back, promoters reduce the floating equity stock in market. Buy back of shares help companies to overcome the problem of hostile takeover by rival firms and others.

Derivatives Trading

Derivatives trading in equities started in June 2000. At present, there are four equity derivative products in India Stock Futures, Stock Options, Index Futures, and Index Options.

Derivative trading is permitted on two stock exchanges in India i.e. NSE and BSE. At present in India, derivatives market turnover is more than cash market.

PAN Made Mandatory

In order to strengthen the “Know your client" norms and to have sound audit trail of transactions in securities market, PAN has been made mandatory with effect from January 1, 2007.

The table shows that the some of the indicators of stock market after the liberalization. The vast increase in primary market resource after 1991-92, that because of the serious steps taken by our government. After 1999 there was slow down in the market because of the dotcom crisis. Again 2002 there seem to an increase in the value. Same way the market capitalization of the companies listed in BSE, NSE shows the tremendous increase in their value. These are all the major impact on our capital market due to the financial reforms.

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Table 1

Some stock market indicators and exposure of some Indian corporates

Year	Resources mobilized from the primary market (Rs. crore)	Market capitalization at BSE (Rs. crore)	Market capitalization at NSE (Rs. crore)	ADRs/GDRs (US$ million)	ECBs (US$ million)
1993–94	24,372	3,68,071	NA	1,597	686
1994–95	27,633	4,35,481	3,63,350	2,050	1,124
1995–96	20,804	5,26,476	4,01,459	683	1,284
1996–97	14,284	4,63,915	4,19,367	1,366	2,856
1997–98	4,570	5,60,325	4,81,503	645	4,010
1998–99	5,587	5,45,361	4,91,175	270	4,367
1999–2000	7,817	9,12,842	10,20,426	768	333
2000–01	6,108	5,71,553	6,57,847	831	4,303
2001–02	7,543	6,12,224	6,36,861	477	-1,585
2002–03	4,070	5,72,198	5,37,133	600	-1,692
2003–04	23,272	12,01,207	11,20,976	459	-2,925
2004–05	28,256	16,98,428	15,85,585	613	5,194
2005–06	27,382	30,22,191	28,13,201	2,552	2,508
2006–07	33,508	35,45,041	33,67,350	3,776	16,103
2007–08	87,029	51,38,014	48,58,122	6,645	22,609
2008–09	16,220	30,86,075	28,96,194	1,162	7,941
2009–10	57,555	61,65,619	60,09,173	3,328	2,522

Source: SEBI hand book on statistics 2012

Conclusion

India has taken dramatic strides in recent years to advance financial sector reforms. But, in a fast-evolving global marketplace, reform is by necessity a continuous process. Nevertheless, the high growth potential of these two economies will likely provide ample opportunities for potentially higher return on capital. The investment management industry people see major opportunities over the next five to ten years, there is a high probability that they will mention the India story. As the cliché goes - “success grows success.” So, going forward, harnessing the benefits of financial sector reforms will be critical.

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