Role and Challenges of Capital Market in India: An Overview

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Abstract: Capital market deals with all arrangements for borrowing and lending term funds (medium term and long term). The demand for long term funds comes from private business corporations, public corporations and the Government. The supply of funds comes largely from individual and institutional investors, banks and special industrial financial institutions and Government. Capital Market consists of Primary Market and Secondary Market. Stock Exchange also plays important role in capital market. Due to speedy economic growth India still faces massive income inequalities, high unemployment, illiteracy and poverty. So there is a need to initiate some reforms for strengthening capital market. The present paper aims at theoretical focusing the role and challenges of Indian capital market in current scenario and also suggests some suggestions for making capital market effective.

Key Words: Capital Market, Stock Market, Bond Market.

INTRODUCTION:

Capital market is a market where buyers and sellers engage in trade of financial securities like bonds, stocks, etc. The buying/selling is undertaken by participants such as individuals and institutions. Capital markets helps to channelize surplus funds from savers to institutions which then invest them into productive use. Generally, this market trades mostly in long-term securities. Capital market consists of primary markets and secondary markets

Primary Market: The primary market is also known as the new issues market. It deals with new securities being issued for the first time. The functions of Primary market is to facilitate the transfer of investible funds savers to entrepreneurs seeking to establish new enterprise or to expand existing ones through the issue of securities for the first time. The investors in this market are banks, financial institutions, insurance companies, mutual funds and individuals. Methods of floatation new issue in the primary market are offer through Prospectus, Offer for Sale, Private Placement, Right issue etc.

Secondary Market: The secondary market is also known as the stock market or stock exchange. It is a market for the purchase and sale of existing securities. It helps existing investors to disinvest and fresh investors to enter the market. It also provides liquidity and marketability to existing securities.

Another important division in the capital market is made on the basis of the nature of security traded, i.e. stock market and bond market.

(i) Bond Market - The bond market which is also known as the credit, or fixed income market is that part of capital market where participants buy and sell debt securities which are usually in the form of bonds.

(ii) Stock Market - A stock market or equity market is a public entity for the trading of company stock i.e., shares and derivatives at an agreed price. For Example: Bombay Stock Exchange or BSE is one of the oldest stock exchanges and also enjoys its stature of being the fourth largest stock exchange in Asia, deals with the trading of securities where about 5,085 Indian companies are listed.

FUNCTIONS OF STOCK MARKET OR STOCK EXCHANGE ARE AS FOLLOWS:

- Providing liquidity and marketability to existing securities

- Pricing of securities
- Safety of transaction
- Contribution to economic growth
- Providing scope for speculation

ROLE OF THE INDIAN CAPITAL MARKET:

The primary role of the capital market is to raise long-term funds for Governments, banks, and corporations while providing a platform for the trading of securities. The member organizations of the capital market may issue stocks and bonds in order to raise funds. Investor can then invest in the capital market by purchasing those stocks and bonds. Capital market has a greater significance in capital formation. For a speedy economic development adequate capital formation is necessary. The importance of capital market in economic development is explained below:-

1. **Capital Formation and Saving Mobilisation** :- In developing countries like India the importance of capital market is self evident. In this market, various types of securities helps to mobilise savings from various sectors of population. The twin features of reasonable return and liquidity in stock exchange are definite incentives to the people to invest in securities. This accelerates the capital formation in the country.
2. **Raising Long - Term Capital :-**The existence of a stock exchange enables companies to raise permanent capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The stock exchange resolves this dash of interests by offering an opportunity to investors to buy or sell their securities, while permanent capital with the company remains unaffected.
3. **Promotion Of Industrial Growth :-**The stock exchange is a central market through which resources are transferred to the industrial sector of the economy. The existence of such an institution encourages people to invest in productive channels. Thus it stimulates industrial growth and economic development of the country by mobilising funds for investment in the corporate securities.
4. **Ready And Continuous Market :-** The stock exchange provides a central convenient place where buyers and sellers can easily purchase and sell securities. Easy marketability makes investment in securities more liquid as compared to other assets.
5. **Technical Assistance :-**An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.
6. **Proper Channelisation Of Funds :-** The prevailing market price of a security and relative yield are the guiding factors for the people to channelise their funds in a particular company. This ensures effective utilisation of funds in the public interest.
7. **Source of Acquiring Foreign Capital: -** Capital markets makes possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. Government has liberalised Foreign Direct Investment (FDI) in the country. This not only brings in foreign capital but also foreign technology which is important for economic development of the country.
8. **Easy Liquidity: -** With the help of secondary market investors can sell off their holdings and convert them into liquid cash. Commercial banks also allow investors to withdraw their deposits, as and when they are in need of funds.

CHALLENGES OF THE INDIAN CAPITAL MARKET:

1. **Inflation** – Inflation is the rate at which the prices for goods and services are rising and subsequently, purchasing power is falling. The inflation situation in the economy continues to be a cause of concern. Despite tightening of the monetary policy by the apex of India, RBI and other steps taken by the government, inflation continues to remain close to the double digit mark. High international oil prices,

high global food prices are some of the causes of high inflation. Investors can predict expected *inflation* is to analyze the commodity *markets,* although the tendency is to think that if commodity prices are rising, *stocks* should rise, since companies "produce" commodities. However, often, high commodity prices squeeze profits, which in turn reduce *stock* returns.

2. **Lack of uniformity of Tax Reforms** - With the non uniformity in the tax system across the states it is a difficult task to carry out the businesses which resulted in undergrowth of the same. The different tax rates implemented in some states across pan India is a major challenge to carry out the business smoothly and also it accounts for a reason of increasing prices of goods and services.
3. **Population** – The current population of India is over 1.25 billion, making it the second most populous country in the world after China, with over 1.35 billion people. India represents almost 17.99% of the world's population which is a serious concern. Due to increasing in the population, the rate of unemployment also rises. So most of the people do not invest in the stock market.
4. **Illiteracy** –The literacy rate in India is 74.04% as of April 2011 population census which constitutes of 65.46% females and 82.14% males. The literacy rate is increasing but the rate of increment is low, which again is a matter of concern.
5. **Steady Growth of Industrial Production** –Steady growth in industrial production trend continues to be a point of concern for the economy. The recent IIP numbers was registered below expectation. Weakness was seen with growth in the capital goods segment, intermediate goods segment and consumer goods segment which slowed down drastically during these months.
6. **Poverty** – About 37 % of Indian population lies below poverty line which is a very alarming situation for a growing economy like India. The main reason for such diversity is the uneven distribution of wealth in the economy where a handful of people are the owner of maximum revenue and the majority of the population is too poor to even arrange for their daily bread. The poor people are high in number, while the high net worth people is very few in numbers.

SUGGESTIONS FOR GROWTH:

To enlarge the capital base the following suggestions will be incorporated

1. To expand the retail investor base for a developed Capital market, and also enhance the investor morale and domestic allocation. Investors' confidence need to be rebuilt through, enhanced investor protection, better transparency, market integrity, market efficiency and enhanced quality of supervision over market intermediaries.
2. To minimise the regulatory procedure and restriction for free and open trade. Regulatory authorities also confused about their area of working in sometime. The most recent conflict between IRDA and SEBI over Unit Linked Insurance Plans (ULIP).
3. To cover the investors residing in small cities also because they have also potential for invest. But lack of guidance enables them to do so. This can be achieved by organizing investor awareness programmes and also few special incentive schemes may be launched for these regions.
4. An initiative has to be taken for the increasing amounts of domestic savings and global investment into the infrastructure sector and other productive sectors.
5. To focus on other instruments like Mutual Funds other than the equities where the funds are managed by big firms and portfolio managers.
6. Interest-rate derivatives are needed to hedge rate risks, the largest macro-economic risk. Globally, interest rate derivatives constitute the largest part of derivatives turnover on both exchange traded as well as OTC products. In India, interest-rate derivates account for less than 1 per cent of turnover.
7. Allow pension funds to invest in investment-grade corporate bonds, credit hedging instruments such as Credit Default Swaps and insurance companies to invest in all investment-grade corporate bonds, creating a liquid benchmark index that can be used for pricing.

CONCLUSION:

After the 1991 economic reforms, the growth of Indian economy showing increasing trends. Capital markets are also changing rapidly. But due to increasing level of competition, India needs to follow through with deeper and more wide ranging reforms which will bring the regulatory environment and the framework of the economy to a level which can cope with the challenges of growth. A practical approach is required by both regulator and service provider. Regulation must not create hurdle for financial engineering and innovation and service providers. As India is poised to develop as a super economic power it must address various challenges associated with the development of capital on priority. It has scope of development in sectors like Pharmaceuticals, Retail industry, Automobiles, Education, etc. FDI should be allowed in various sectors to attract the foreign investors so that growth of economy will be done.

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