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# AN ANALYSIS OF CAPITAL MARKETS AND ECONOMIC GROWTH OF INDIA

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***Abstract***

*Over the years, the Indian economy has steadily increased and many sectors have witnessed significant contribution to Indian Economy. In this paper, an attempt is made to critically examine the capital market in India and its role and impact on the economic growth of India. Capital market has been one of the lucrative sectors for investment for potential investors. The investments spent in the capital market have been attractive and resulted in a positive perspective for the investors. In this paper, a detailed examination is made to understand the functions and significance of Capital market in India and further, its role is been examined through the help of secondary data sources.*

***Key words: Derivatives, Economy, equity, FDI, SEBI.***

## 1. Introduction

According to Will Kenton(2019), "the capital markets are the venues where savings and investments are channelled between the suppliers who have capital and those who are in need of capital". The entities that have capital include retail and institutional investors while those who seek capital are businesses, governments and people.

Capital market is referred to as a place where saving and investments are done between capital suppliers and those who are in need of capital. It is, therefore, a place where various entities trade different financial instruments. The capital market provides the support to the system of capitalism of the country. The Securities and Exchange Board of India (SEBI), along with the Reserve Bank of India are the two regulatory authority for Indian securities market, to protect investors and improve the microstructure of capital markets in India. With the increased application of information technology, the trading platforms of stock exchanges are accessible from anywhere in the country through their trading terminals.

**There are two types of capital market**:

1. Primary Market
2. Secondary Market

Capital market is where both equity and debt instrument like equity shares, preference shares, debentures, bonds, etc. are bought and sold.

### A) Primary Market

The primary market is a new issue market; it solely deals with the issues of new securities. A place where trading of securities is done for the first time. The main objective is capital formation for government, institutions, companies, etc. also known as Initial Public Offer (IPO). Now, let us have a look at the functions of primary market:

1. **Origination:** Origination is referred to as examine, evaluate, and process new project proposals in the primary market. It begins prior to an issue is present in the market. It is done with the help of commercial bankers.
2. **Underwriting:** For ensuring the success of new issue there is a need for underwriting firms. These are the ones who guarantee minimum subscription. In case, the issue remains unsold the underwriters have to buy. But if the issues are completely subscribed then there will be no liability left for them.
3. **Distribution:** For the success of issue, brokers and dealers are given job distribution who directly contact with investors.

**B) Secondary Market**

The secondary market is a place where trading takes place for existing securities. It is known as stock exchange or stock market. Here the securities are bought and sold by the investors. Now, let us have a look at the functions of secondary market:

a. Regular information about the value of security
b. Offers liquidity to the investors for their assets
c. Continuous and active trading
d. Provide a Market Place

**2 Functions of Capital Market**

a. It acts in linking investors and savers
b. Facilitates the movement of capital to be used more profitability and productively to boost the national income
c. Boosts economic growth
d. Mobilization of savings to finance long term investment
e. Facilitates trading of securities
f. Minimization of transaction and information cost
g. Encourages a massive range of ownership of productive assets
h. Quick valuations of financial instruments
i. Through derivative trading, it offers insurance against market or price threats
j. Facilitates transaction settlement
k. Improvement in the effectiveness of capital allocation
l. Continuous availability of funds

The capital market is the best source of finance for companies. It offers a spectrum of investment avenues to all investors which encourage capital creation.

**3 .Importance of Capital Market**

1. It is only with the help of capital market, long-term funds are raised by the business community.
2. It provides opportunity for the public to invest their savings in attractive securities which provide a higher return
3. A well-developed capital market is capable of attracting funds even from foreign country. Thus, foreign capital flows into the country through foreign investments.
4. Capital market provides an opportunity for the investing public to know the trend of different securities and the conditions prevailing in the economy.
5. It enables the country to achieve economic growth as capital formation is promoted through the capital market.
6. Existing companies, because of their performance will be able to expand their industries and also go in for diversification of business due to the capital market.
7. Capital market is the barometer of the economy by which you are able to study the economic conditions of the country and it enables the government to take suitable action.
8. Through the Press and different media, the public are informed about the prices of different securities. This enables the public to take necessary investment decisions**.**
9. Capital market provides opportunities for different institutions such as commercial banks, mutual funds, investment trust; etc., to earn a good return on the investing funds. They employ financial experts who are able to predict the changes in the market and accordingly undertake suitable portfolio investments.

**3. Objectives and Methodology of the Study**

The paper primarily aimed to critically examine the role of Capital market towards Economic growth in India and to evaluate the performance of Capital market in India. The paper is based on the secondary data sources obtained from SEBI reports, statistics obtained from BSE, NSE reports, RBI reports and reviews made by the authors in select journals, magazines and online articles.

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**4 Role of Capital market towards Economic growth in India**

Financial market deals about the raising of finance by various institutions through the issue of various securities. Every business concern requires two types of finance. They are Short-term or working capital requirements and long-term or fixed capital requirements. The short-term or working capital requirements are raised or borrowed in the money market through the issue of different securities such as bills, promissory notes, etc.

I) **Role and Importance of Capital Market In India**

The capital market has a crucial significance to capital formation. For a speedy economic development, the adequate capital formation is necessary. The significance of capital market in economic development is explained below:

**II) Mobilization of Savings And Acceleration Of Capital Formation**

In developing countries like India, the importance of capital market is self-evident. In this market, various types of securities help to mobilize savings from various sectors of the 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.

**III) 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.

**IV) 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 mobilizing funds for investment in the corporate securities.

**V) 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 an investment in securities more liquid as compared to other assets.

**VI) Technical Assistance**

An important shortage faced by entrepreneurs in developing countries is technical assistance. By offering advisory services relating to the preparation of feasibility reports, identifying growth potential and training entrepreneurs in project management, the financial intermediaries in capital market play an important role.

**VII) Reliable Guide To Performance**

The capital market serves as a reliable guide to the performance and financial position of corporate, and thereby promotes efficiency.

**VIII) Proper Channelization of Funds**

The prevailing market price of a security and relative yield are the guiding factors for the people to channelize their funds in a particular company. This ensures effective utilization of funds in the public interest.

**IX) Provision of Variety Of Services**

The financial institutions functioning in the capital market provide a variety of services such as a grant of long-term and medium-term loans to entrepreneurs, provision of underwriting facilities, assistance in the promotion of companies, participation in equity capital, giving expert advice etc.

**X) Development of Backward Areas**

Capital Markets provide funds for projects in backward areas. This facilitates economic development of backward areas. Long-term funds are also provided for development projects in backward and rural areas.

**XI) Foreign Capital**

Capital markets make possible to generate foreign capital. Indian firms are able to generate capital funds from overseas markets by way of bonds and other securities. The government has liberalized Foreign Direct Investment (FDI) in the country. This not only brings in the foreign capital but also foreign technology which is important for economic development of the country.

**XII) 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.

The capital market effectively transfers monetary purchase power from surplus funds of investors to those with deficits for a fixed period in exchange for greater future purchasing power. They play a major role in recapitalizing and privatization of large infrastructure projects and industries. The privatization of banks, insurance companies, real-estate sectors, etc is a good example of this strategy.

1. Capital market channelizes and increases long-term savings to fulfill the monetary demands of companies with deficit funds to form long-term investments like pension funds, funeral expense covers, individual fixed investments, etc. This is especially useful for companies who wish to avail funds for a small price without going in for a change in ownership rights from private holding to equity holding etc.

2. Capital markets help provide equity for infrastructure development needs which tremendously impacts and provides for water and sewer systems, development of roads, energy, housing, telecommunications, socio-economic benefits provisions, public transport, and many more. Governmental bonds are the present means of financing such needs and provide the investors with low-risk appetites a guaranteed pay-back after the fixed term with an attractive interest rate.

3. Empowers the government strategy of social inclusion and economic growth through providing platforms and thrust areas wherein industries can compete globally, forge private-public partnerships, use capital efficiently, increase domestic productivity and spur growth, global integration, and better economic development.

4. The capital market mechanism provides for regulating the markets, covering risks according to appetites, ensures good investor returns, and prevents complete decay of stock market policies.

Government raises the short-term funds through the issue of treasury bills. Banks play a vital role in providing short-term funds. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market. The long-term funds or fixed capital are raised by companies by the issue of shares, debentures and bonds in the capital market.

India's recent progress towards economic liberalisation has entailed wide-ranging measures aimed at improving India's economic performance right across the board. Perhaps none, however, have been as successful as those applied to the country's financial markets. The development of the institutions, regulations, and practices surrounding India capital markets is on a par with the best in the world. The development of the country's capital markets has played a significant role in facilitating investment and economic growth. It continues to evolve, offering more opportunities for both foreign investors and, with the added potential of the Indian retail sector, for India's financial services sector too." With stock markets that have outperformed the global indices for the best part of a decade, the recent history of India's capital markets is one of significant achievement.

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**5 Performance Evaluation of Capital Market**

Since 2016, the Indian capital markets have charted such an astounding performance that it left even the most astute investors scratching their heads. Delivering higher than expected returns in most investments, the Indian stock market lured not only the domestic crowd, but attracted attention of global stalwarts as well. The figure below shows the trend of investments made foreign institutional investors/ foreign portfolio investors in the Indian capital market during the past few calendar years. he volume of the foreign investments reached its peak in the recent years in 2014, which gradually came down from the very next year and in 2016 the net foreign investments by FII/ FPIs became negative, this is mainly due to high level of withdrawals during the last two months of the year, i.e., November and December, during which the country was undergoing the crisis of demonetization. However, the market bounced back very sharply within a year only, with the net foreign investments growing by over 8 times.

**A) Performance of IPOs**

Indian IPO issuances primarily occur during times of booming economic environment and when the company sees a dominant bullish sentiment in the market. They are usually priced at very low prices so that market outlook remains positive when it gets over-subscribed. IPOs may be issued by established stalwarts- like Avenue Supermart or by younger companies looking to stretch their capital horizons- case in point being Prataap Snacks. Indian companies choose this route generally when they are looking to repay existing debts that the company may have and to finance future projects. The Indian primary market has kept pace with the secondary market performance and has resulted in investors earning quick and positive returns. The Indian IPO market has experienced a structural change; earlier, IPOs used to be bought generally by specialized and long term investors but these days IPOs have become very popular among the retail investors as well. The IPO market has kept climbing the ladder in recent years and attracted more and more prospective companies to register themselves with SEBI.

**B) ADR/GDR**

Once a very popular choice of raising funds, American Depository Receipt and Global Depository Receipt market has become stagnant, with not a single company opting to issue one in order to raise funds overseas. ADRs and GDRs allowed Indian companies to capture a more diverse set of investors and advertise their company beyond domestic territories as well. In recent years, fewer and fewer companies opt for this method given the high regulatory requirements put in place and the fact that the country is experiencing a net inflow of foreign money rather than outflow, not to mention the strong rupee performance globally. Those companies that still need foreign investment are choosing to issue foreign currency convertible bonds instead, which has proven to be a more lenient and efficient way of raising funds. The steep decline in issuance of ADR and GDR market is evident by the recent year’s figures, with not a single issuance taking place in the year 2017.

**C) Private Placement**

Private placement has proven to be an attractive source of finance for various start-ups and up and coming SMEs and listed entities on the look-out for strategic investors. Institutional Investors such as banks, pension funds, etc. and Venture Capitalists help kill two birds with one stone as not only do they provide finance, the strategic advise that comes along is certainly the icing on the cake. Such financing has been regarded to be a lucrative option to those companies for whom counsel is more important than cash.

The rising prominence of private placement market is evidenced by the fact that the year 2016-17 accounted for the highest volume and amount of issuances, with a record 3436 deals amounting to Rs. 6.67 trillion as per RBI data.The market maintained pace as Indian companies raised approximately Rs 3.24 trillion in the first half year (HY1) of FY17-18- an increase of 4% from the corresponding period a year ago.

**D) Public Issue**

Listed entities on NSE and BSE raised approximately Rs.295.47 billion in FY17 through issuance of corporate bonds. So far in FY18, companies have raised 38.95 billion.

Debt issuance has proved to be an effective way for young companies who are not willing to part with equity but are in need of financing and hence choose to raise funds by issuing bonds. The rise in mutual funds industry in India, along with a more favourable outlook towards stock market rather than commodity investment such as real estate and gold has been part of the reason why public issuance has flourished in the country. The surge of foreign investments in the country has primarily comprised of investment in the corporate bond market- piggy-riding the domestic sentiment on its back as well. In the year 2017, foreign investment in corporate bonds has risen by a staggering 44%, amounting to Rs. 2.3 trillion, coming dangerously close to the cap of Rs. 2.4 trillion permitted by RBI to foreign investors.

**E) Securitisation in India**

Still taking its first steps in the Indian scene, Securitisation remains in nascent stage in the country. The Indian securitization market has started to take off in recent years, with FY17 charting the highest figures of around Rs 1.02 lakh crores in terms of value of securitized transactions. This increase has majorly been on account of abolishment of Distribution Tax on the income distributed by the trust to investors. The new regime instead transfers the liability of securitization distribution tax from the hands of the trust to the investors. This was a major reason behind the growth in issuance of Pass-through Certificates or PTCs, which rose by almost 74% to Rs. 42800 crores.

**F) Mutual Funds**

The year 2017 can aptly be labelled as “The year of Mutual Funds” in India. If there is one sector that has played all its cards right and gotten more than it has bargained for, it has to be the Mutual Fund industry in India. Perhaps the only industry that has been making headlines for all the right reasons since the implementation of Demonitization, Mutual Fund has been the lips of every household, even the ones who have no idea what a mutual fund is, have at least heard of the dialogue “Mutual Fund investments are subject to market risks…” and so on, such has been the powerful marketing campaign as chosen by the Association of Mutual Funds in India(AMFI), another major factor behind the rising clout of Mutual Funds industry. Net inflows into mutual funds in 2016-17 reached Rs. 3.43 trillion, a staggering leap of around 155% compared to the year before and the highest figure since its inception in the country. The Assets Under Management (AUM) of the Mutual Fund industry reached a high of Rs. 19.5 lakh crores in FY17, a threefold growth in the last 5 years. The fact that Sensex has soared to levels of 32600 and increased by 22% since the turn of year, has made investment in Mutual Fund a popular choice as every other Indian household entrusts their money with the fund to provide them a piece of the pie that is the Indian stock market. The equity assets of Mutual Fund comprise around one-third of the total portfolio, with the Mutual Funds holding 5.5% of the outstanding equity stock as per AMFI-CRISIL study

**6 Conclusions**

While the party for the capital markets in India seems to have just started, a closer look at the figures do reveal reasons for concern. Domestically, the banking institutions remain decapitated by the woes of rising stressed assets, which have reached a perilous figure of Rs. 7 lakh crores. This has led to over-reliance on ECBs and FIIs, which exposes more and more companies to currency risk and exposes the fragility that surrounds the industry. The capital market in India not only increases the facility of trading of securities thus providing the capital support from the companies but also provide significant contribution to boost the growth of Indian economy. Despite the recession, the economy has been seen tremendous progress due to increasing investments in capital market. IPOs have become very attractive to retail investors, apart from that, the Global Deposit Receipt market has also raised significantly. The raise of bonds and mutual funds has altogether contributed significantly to the economic growth of the country.

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