EFFECTS OF REFORMS ON INDIAN CAPITAL MARKET

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The last decade witnessed the maturity of India's financial market. Since 1991, every governments of India took major steps in reforming the financial sector of the country. India's financial sector, In terms of institutions, markets and infrastructure has expanded and acquired greater depth and vibrancy as a result of the ongoing reforms. We have witnessed a wide range of reforms in different segments of our financial sector like •Financial markets •Regulators •The banking system •Non-banking finance companies• The capital market• Mutual funds •Deregulation of banking system etc.

The present study deals in the developments in thecapital market.

Major Reforms and Developments in Indian capital market

1. SEBI Act, 1992

The SEBI Act of 1992 provided SEBI with rule-making and monitoring authority to overseeIndia's exchanges and brokers, and to register and authorize all initial public offerings (IPOs).To protect investors, the Act authorized SEBI to regulate matters relating to issue of capital,transfers of securities and other matters incidental thereto, the ways in which such mattersmay be disclosed by companies, and the requirements for listing and transfer of securities andother related issues.SEBI issued regulations for Stock Brokers and Sub-brokers, Merchant Bankers and InsiderTrading and Disclosure Investor Protection Guidelines. SEBI asserted authority over mutualfunds, other than UTI, through the issuance of Mutual Fund Guidelines, in 1993 andregulations in 1996. Over the ensuing decade, SEBI issued a range of regulations andguidelines that shaped market operations.

2. Depositories Act of 1996

India took a major step toward market modernization with the enactment of the Depositories Actof 1996. This act established the rights and obligations of depositories, participants, issuers, andbeneficial owners. Section 9 of the act requires that all securities held by a depository shall bedematerialized and in fungible form. Because the Depositories Act ensured the free transferabilityof securities with speed, accuracy, and security, it was fundamental to the market's transformation.The act allowed the market to move from a slow, risky, paper-based settlement to electronicdematerialized securities that eliminated many of the pre-existing impediments to swift and safesettlement. Dematerialization was the first step in applying systems such as straight-throughprocessing (STP), real-time gross settlement (RTGS), and electronic funds transfer that led to thesecurities market achieving T+2 settlement.

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3. Legislation on Derivatives Trading

Three legislative steps cleared the path for derivatives trading in India:

• The Securities Laws (Amendment) Ordinance of 1995 withdrew the prohibition on options in securities.

• The Securities Contracts Regulation Act (SCRA) was amended in December 1999, to include derivatives within the ambit of “securities.” Derivatives were defined to include “(a) a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences, or any other form of security, and (b) a contract which derives its value form the prices, or index of prices, or underlying securities.”

• In March 2000, the Government rescinded the three decades old Notification which prohibited forward trading in securities.

4. SEBI (Amendments) Act of 2001

Just as the 1992 market scandal prompted regulatory and market reforms a decade earlier, in 2001,another scandal prompted a strong regulatory and market response. In the spring of 2001, it wasrevealed that prices of several market scrips had been manipulated on several prominent exchanges financed through unauthorized funds of banks and brokers. The revelation shook confidence in the market and in the ability of the exchanges and regulatory structure to police the market. The Joint Parliamentary Committee (JPC) appointed in April 2001 to investigate the issue concluded that SEBI needed to decisively improve its procedures, vigilance, enforcement, and control mechanisms. It also recommended amending the SEBI Act to enhance SEBI’s investigative and enforcement powers.

Following JPC’s recommendations, in 2002 several amendments to the SEBI Act of 2001 wereadopted. Key among these amendments were those that identified SEBI as the primary regulatorof the securities market, giving it search and seizure powers and the ability to impose meaningfulpenalties.

These rules and guidelines, too numerous to discuss individually, include regulations relating to theissuance and buy back of securities; corporate governance in listed companies; custodians; depositoriesand participants regulations; derivatives; fit and proper person; foreign institutional investors (FIIs) andventure capital investors; investor protection; market participants (central database); mutual funds;portfolio managers; the Securities Appellate Tribunal; securities lending and borrowing; self-regulatoryorganizations; straight -through processing; stock brokers/sub-brokers; takeover regulations; andvanishing companies.

5. Enhanced Market Surveillance and Efficient Enforcement

In addition to modernizing the legal and legislative frameworks for market regulation, SEBI took steps to significantly strengthen and broaden its ability to oversee the markets and exchanges. Most noteworthy was the implementation of an integrated market surveillance system (IMSS) and the development of expanded enforcement tools.

On December 1, 2006, SEBI activated its IMSS, a modern comprehensive electronic surveillance system that enables the regulator to quickly detect suspicious market activity in any market and across all markets.

6. Market Systems and Infrastructure

India has capitalized on significant technological advances to improve the efficiency and transparency of its securities market. Technology has driven much of the change in the market.. The technology based systems and innovations helped to: • Minimize systemic and settlement risk, such as through securities trading in dematerialized form with settlement in T+2; straight-through processing (STP); real-time gross settlement (RTGS); electronic fund transfer (EFT) used by securities market clearing banks; and the realtime, state-of-the-art systems at the clearing corporations. • Improve SEBI oversight of exchanges, brokers and investors; increasing the accountability of professional marketparticipants; and helping to detect and discourage insider trading, manipulations, and market scams, as through SEBI's Integrated Market Surveillance System (IMSS); • Broaden the scope and reach of intermediaries, enabling them to establish electronic networks to expand throughout India and to develop internet trading accounts • Improve the transparency of major market institutions, such as thewebsites maintained by SEBI, exchanges, and AMFI, and the transparency of the issuers whosesecurities are registered with SEBI and listed and traded on India's stock exchanges.

7. Creating New FinancialInstruments: The DerivativesMarket

Of the many achievements in the Indiancapital market over the past 15 years, themost sudden, recent, and dramatic is thedevelopment of the derivatives market. It hascatapulted the market to new levels ofsophistication and maturity.Derivatives trading in India began in June2000, with trading in stock index futurescontracts. By the fourth quarter of 2001, eachof India's two largest exchanges had fourequity-derivative products: futures andoptions for single stocks, and futures andoptions for their respective stock indices. Trading was introduced in four steps:

1. June 2000: Stock-index futures contracts begin trading on the BSE's BSE-30 (Sensex) and the NSE's S&P CNX Nifty Index.
2. June 2001: Stock index options on these indices are introduced on the BSE and the NSE.
3. July 2001: Single-stock options on the 31 most actively traded stocks regardless of where listed begin trading on both the BSE and the NSE.
4. September 2001: Single-stock futures trading on the same 31 most actively traded stocks is approved by SEBI, and trading in them begins shortly thereafter.

By June 2007, derivatives trading had surged.During the seven years since June 2000, theNSE has become the largest exchange insingle stock futures in the world, and by June2007, it ranked fourth globally in tradingindex futures, a sign of an evolving andmaturing market.

8. Improving DisclosureStandards and TransparencyMilestones

Toattract foreign direct and indirect investmentand to satisfy international and institutionalinvestors, with support from issuers, SEBIand the ICAI, India's accounting standardsmoved toward greater transparency and fullconvergence. Again, this movement has beenmarked by a number of milestones:

• SEBI's acceptance of internationaldisclosure requirements alongside itsown requirements.• SEBI's establishment of anAccounting Standards Committee asa standing committee in 1998-99.• SEBI's regular upgrading of its listingagreement requirements to bringthem closer to internationalstandards, most recently with newClause 49 of the listing agreement.

• The recommendationsof the KumarMangalam BirlaCommittee on Corporate Governancethat India movespeedily to adoptinternational standards,with specificrecommendations forpresentation ofconsolidated financialstatements, segmentreporting, anddisclosure of relatedparty transactions,which were realized in 2000 throughSEBI's changes in the listingagreement.

• The recommendations of theNarayana Murthy Committee onCorporate Governance thatmanagement justify any accountingtreatment different than that requiredby an accounting standard realized bySEBI's changes in new Clause 49 ofthe listing agreement.

• Establishment by the government ofthe National Advisory Committee onAccounting Standards (NACAS) in2001.

• SEBI's implementation of EDIFAR in2002 to permit electronic reporting anddissemination of financial reports andother issuer information.

• Movement of SEBI and the Instituteof Chartered Accountants of India(ICAI) toward adoption of theInternational Accounting StandardsBoard's (IASB's) InternationalFinancial Reporting Standards (IFRS),including, since 2000, adoption by theICAI of many new standards thatdiffer very little from IFRS.

9. New Measures of Risk Management System in Indian Capital Market

Every shareholderor investor wants to protect his investment and promote it as his source of earning. So, my always concentration is on new measures the Risk management system of SEBI which is the controller of Indian Capital Market. SEBI did several steps in this regards.

{ A } Measures for Reducing Price Volatility

Volatility is often viewed as a negative term in the market that represents uncertainty and risk. Higher volatility brings worry to the investors as they watch the value of their portfolios move wildly and decrease in value. To reduce price volatility and stability in the prices of stock market, A major reform undertaken by SEBI was the introduction of derivatives products: Index futures, Index options, stock options and stock futures.

The volatility measured as standard deviation of daily log returns in per cent is tabulated below for pre futures and futures period.

Table 3: Daily Return Volatility (Standard deviation in per cent)

Index	Pre futures (Jan 98–Jun 00)	Futures (Jun 00-Oct 02)
S&PCNX Nifty	1.96	1.45
BSE 100	2.11	1.68
Sensex	2.03	1.54

From the above Table 3 it is clear that volatility has come down after introducing index futures contracts when compared to before the pre introduction period.

{B} Place Circuit Breakers

This is another recent development in Indian Capital Market. We all know an excessive speculation is always risky for every investor. For reducing it, SEBI has introduced place circuit breakers. A circuit breaker is the system which stops to trade in stock market when prices move after a specific level. For example, if a stock is at Rs. 100 and circuit breaker is fixed at 5%, then stock trading will stop if it hit of Rs. 95 or Rs. 105. There are mainly two types of circuit breakers. One is index wise circuit breakers and other is stock wise circuit breakers.

The index-based market-wide circuit breaker system applies at 3 stages of the index movement, either way viz. at 10%, 15% and 20%. These circuit breakers when triggered bring about a coordinated trading halt in all equity and equity derivative markets nationwide. The market-wide circuit breakers are triggered by movement of either the BSE Sensex or the NSE S&P CNX Nifty, whichever is breached earlier. In case of a 10% movement of either of these indices, there would be a one-hour market halt if the movement takes place before 1:00 p.m. In case the movement takes place at or after 1:00 p.m. but before 2:30 p.m. there would be trading halt for ½ hour. In case movement takes place at or after 2:30 p.m. there will be no trading halt at the 10% level and market shall continue trading. In case if the market hits 10% before 1 p.m. then as explained there would be a one hour halt in trading and after resumption of trade in case if the market hits 15% in either index, then there shall be a two-hour halt. If the 15% trigger is reached on or after 1:00p.m. but before 2:00 p.m., there shall be a one-hour halt. If the 15% trigger is reached on or after 2:00 p.m. the trading shall halt for the remaining part of the day.

{C} Intraday Trading Limit

Intraday Trading, also known as Day Trading, is the system where you take a position on a stock and release that position before the end of that day's trading session. Thereby making a profit for yourself in that buy-sell or sell-buy exercise. All in one day.

{D} Mark to Market Margin

MTM margin is imposed to cover loss that a member may incur, in case the transaction is closed out at a closing price different from a price at which the transaction has been entered. It is just collection in cash for all futures contracts and adjusted against the available Liquid Networth for option positions. In the case of futures Contracts MTM may be considered as Mark to Market Settlement. .

{E} Investor Awareness Campaign

For making Indian capital market more secure for indian and foreign investors, SEBI has started investors awareness campaign. For this, SEBI has made his official site's sub domain at http://investor.sebi.gov.in/under this campaign, Workshops/ Seminars Conducted by Investor Associations recognised by SEBI. There are following things are included:

Caution to Investors

- Do not enter into securities transactions with unregistered intermediaries.
- Do not get carried away by advertisements promising unrealistic gains and windfall profits.
- Do not invest based on market rumours or unconfirmed or unauthentic news.
- Be aware that advice through television or print media does not mean that it is the opinion of the channel or publisher.

{F}Ban on Insiders Trading

Insider trading is the trading of a corporation's stock or other securities (e.g. bonds or stock options) by individuals with potential access to non-public information about the company. In most countries, trading by corporate insiders such as officers, key employees, directors. To ban on insider trading, SEBI has made (Prohibition of Insider Trading) Regulations, 1992. Its updated amendment in 2010 says in clear words

No insider shall— [when in possession of] any unpublished price sensitive information; communicate [or] counsel or procure directly or indirectly any unpublished price sensitive that nothing contained above shall be applicable to any communication required in [or profession or employment] or under any law.

Company while in possession of any unpublished price sensitive information.][3A. No company shall deal in the securities of another company or associate of that other

(i) Either on his own behalf or on behalf of any other person, deal in securities of a company listedon any stock exchange or information to any person who while in possession of such unpublished price sensitive information shall not deal in securities: Provided the ordinary course of business

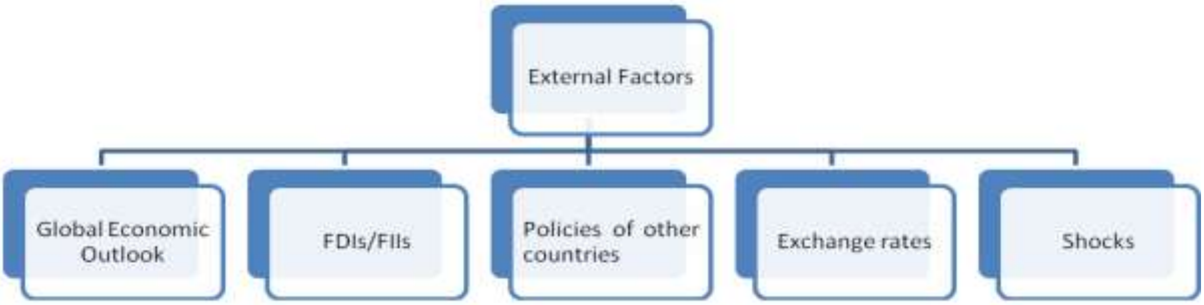
{G} Trading Cycle Under T + 2,

T' represents the trade day. 'T + 2' implies the settlement on the 2th trading day. SEBI has reduced the settlement cycle upto T +2 and in future, it may be T + 1 settlement cycle. But SEBI accepted shorter settlement cycles will mean more pressure on trade processing systems so that funds/securities are ready for pay-in/pay-out on the next day.

FACTORS DRIVING INDIAN CAPITAL MARKET

The **90s** were the most crucial in the stock market's history. Indians became aware of 'liberalization' and 'globalization'. In May 1992, the Capital Issues (Control) Act, 1947 was abolished. SEBI which was the Indian Capital Market's regulator was given the power and overlook new trading policies, entry of private sector mutual funds and private sector banks, free prices, new stock exchanges, foreign institutional investors, and market boom and bust.

The major factors driving the Indian equity market can be broadly classified into 2 categories: **External & Internal** as shown below:

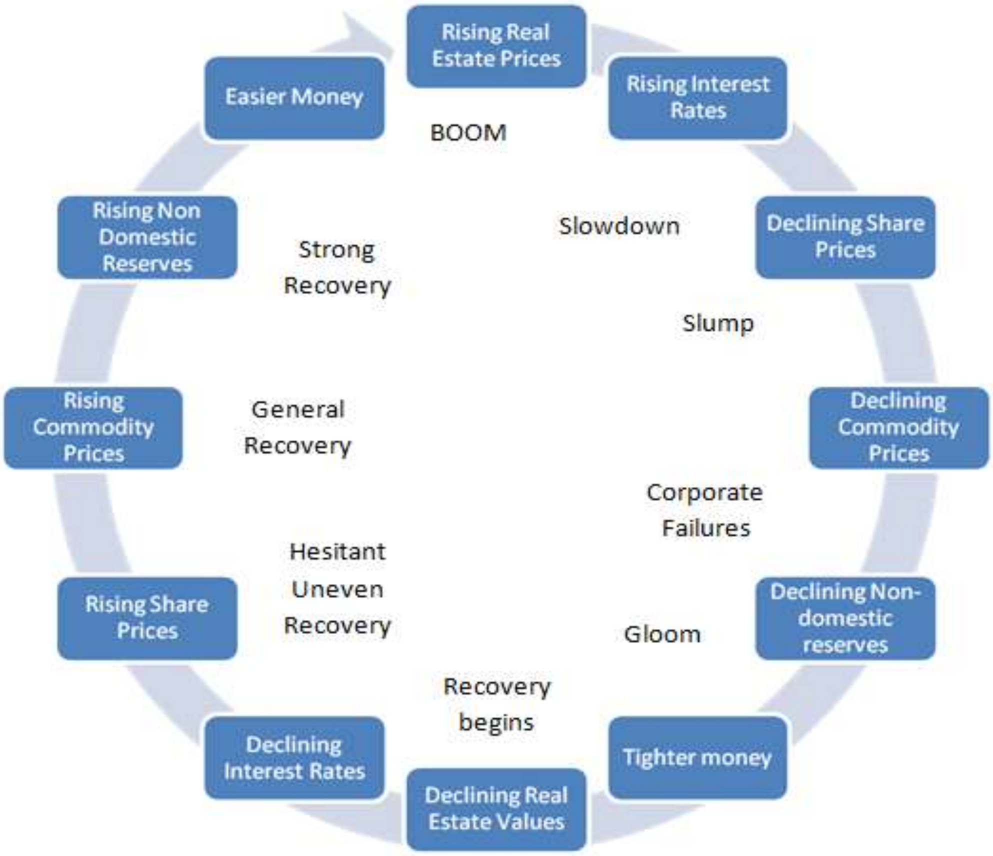


I would now proceed to briefly describe and illustrate the relationship between these factors and the Indian equity markets:

External Factors:

Global Economic Outlook

Most global free market economies go through a cycle of booms and glooms as shown in this diagram:



Foreign Direct Investment comes in the form of involvement in direct production activities and is of a medium-long term nature. The investor acquires the ownership of assets for the purpose of controlling the production, distribution and other activities of the firm. FDIs facilitate international trade and transfer of knowledge.In the present economic scenario, where the countries are highly reliant on Foreign Trade & Foreign Investors, a major downturn in one major country affects all other countries. As we saw recently, due to fears of Greece defaulting on its loans, there was FII/FDI withdrawal from the Indian Equity Market as well. In the globalized market scenario, the impact of a recession in one country percolates down to all the linked industries. For example: India has the highest number of outsourcing deals from the US. Even our exports to US have increased over the years. The collapse of one bank in US led to a "Liquidity Crunch" all over the world.

We were slightly better protected from the recent financial meltdown, largely because of the still large role of the nationalized banks and other controls on domestic finance.

FDI/FIIs

An institutional investor is any investor or investment fund that is from or registered in a country outside of the one in which it is currently investing. These include hedge funds, insurance companies, pension funds and mutual funds. The growing Indian economy has resulted in several FIIs to invest in Indian equity markets.

FIIs are, however, a short term investment and can have bidirectional causation with the returns of other domestic financial markets such as money markets, stock markets, and foreign exchange markets. Hence understanding the dynamics of FII is very important for any emerging economy. A withdrawal by FIIs leads to a sharp depreciation of the rupee.

FDI and FIIs are generally preferred over other forms of external finance, because they do not create any debt, they are non-volatile and their returns depend upon the projects financed by the investor.

Policies of Other countries

Any decision taken by other countries that affects the amount of investment that will be done in India will definitely affect the Indian equity market. For example, when US Senate ratified the Indo-US Civil Nuclear Deal, the Indian equity market jumped as it expected more and more investments coming to India. Another example is that when Recently, Chinese news of Yuan free float had its affect on crude oil as well and it started rising but fell later on when it was realized that the impact of this would be very limited.

Exchange Rates

The performance of exchange rate markets also plays a role in the determination of the financial market. When the Indian rupee had increased to about Rs. 41 against the US dollar it lowered the country's import prices but it also hit the exporters hard thus driving down their equity.

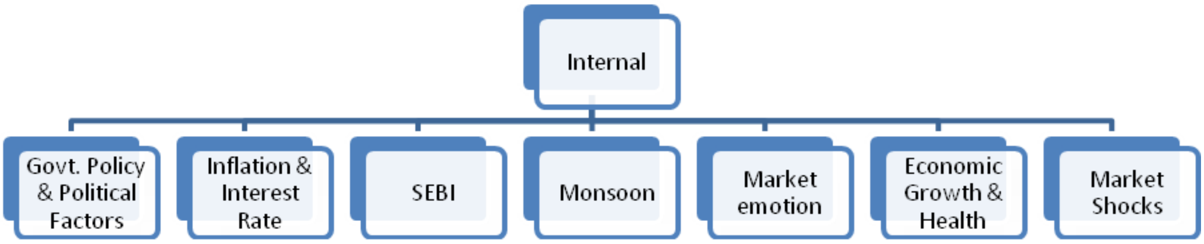
A sharp depreciation of the rupee may be good for India's exports that were adversely affected by the slowdown in global markets; it is not so good for those who have accumulated foreign exchange payment commitments. Moreover, a depreciating rupee doesn't help the Government to rein in inflation.

Shocks

When Lehmann Brothers filed for bankruptcy, markets all over the world tumbled. Such shocks not only affect the local market but market in India as well given the huge amount of investment in Indian markets by FIIs/FDIs. Similarly, markets tumbled following the news of Merrill's take over, AIG's request for bail out etc.

When Crude oil prices rise suddenly, there is more pressure on the government to raise domestic petrol/diesel prices. If the government does that, stock prices of oil majors like IOC, BPCL, HPCL and other related oil and gas companies like Reliance petrol, Essar oil, RNRL stocks go up.

Internal Factors



Government Policy and Political Factors

There are also some other extraneous factors affecting the movement of the stock market such as the political situation and stability in the government. Deregulating an industrial sector will have a positive impact on the stock market. War periods and periods of a stagflation and unemployment are likely to have telling effects on the stock market performance and the economy may be headed towards a recession.

Elections affect the Indian equity market in a huge way. Recently, we have seen a series of coalition governments some of which have also seen the participation of the Left. A coalition with the left implies that there will no major economic reforms which drown market spirits as it threatens to slow the FIIs coming into India.

Inflation and Interest Rates

The RBI plays an important part in the development strategy of the government. It is the duty of RBI to control the inflation rate and interest rates in the market. Although higher inflation rates spur higher growth rates but the vast disparity of income in Indian population makes it impossible for the poorest in India to buy basic commodities.

SEBI

The functions of the Equity Market in India are supervised by SEBI (Securities Exchange Board of India). SEBI provides major guidelines to the markets. For example: It decides which investors can comprise a QIB (Qualified Institutional Buyer). Then it specifies that QIBs shall not be promoters or related to promoters of the issuer, either directly or indirectly. Besides, QIBs cannot have either veto rights or the right to appoint any nominee director to the board because that would also be considered to be related to the promoter. Hence, SEBI has a huge role to play in Indian Equity markets.

Monsoons

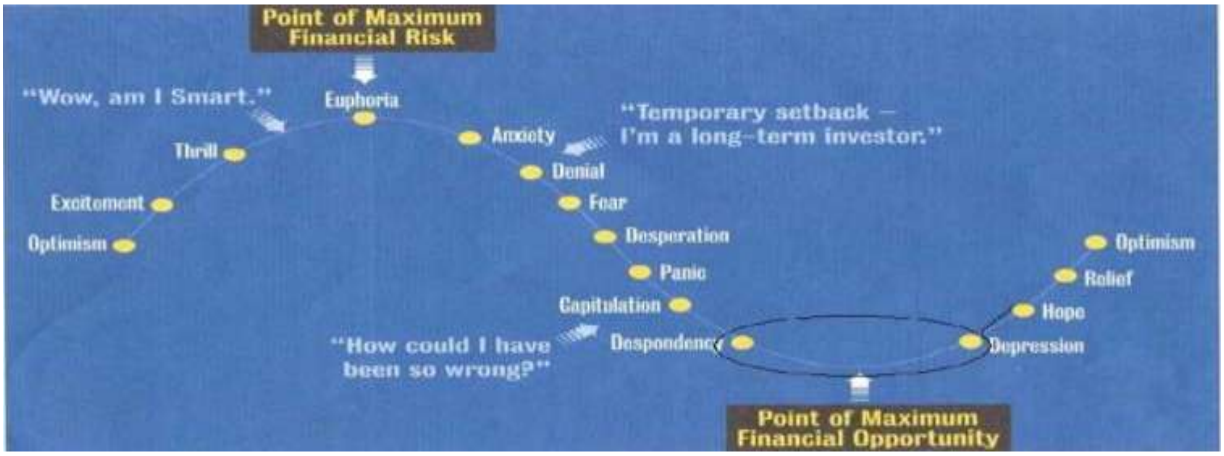
In India, agriculture provides around 70% of employment either directly or indirectly. This is the major reason for the economic growth of India to depend on Monsoon season. Monsoon season in India starts from June and continue till September. If the monsoon is good, it boosts up the economy of the country and helps in maintaining GDP growth. But if monsoon rains get delayed even by 15 days as was the case last year in 2009, it becomes a cause of worry for the government.

Good rainfall means government can ease restrictions on the export of wheat and rice, and good rainfall will boost output of grain and oil seeds, and help calm inflation.

Less rainfall implies prices of agricultural products will go up and affect the consumers drastically. It might lead to a condition of drought in several states of India which forces the government to drop import tax on a number of commodities, including sugar. It also causes shortage of water supply for production of power and electricity. Electricity shortage has a strong effect on almost all sectors, which also causes delay in productions or increase in costing of products. Less rain affects the purchasing power in the rural areas and contract demand for products and services. This is not good news for FMCG companies which depend on agricultural and rural market.

Market Emotion

Stock market performance is largely seen as an indicator of the development of a particular country and over expectations about its performance could lead to stock market bubbles which might burst any time.



News is another factor that affects the share price. When there is positive news about a particular stock or company, people try to invest all their money in that particular stock or market. This leads to increase in the interest of buying the stock. But there are many circumstances where news could also bring a negative effect where it could ruin the prospect of the particular stock. So it is very important to know the overall news of a stock or company where you can invest your money so that it grows within a very short period of time.

Effects of Equity Market Reforms

The Indian Equity Market or the Indian Stock Market is the third biggest market in Asia after China and Hong Kong. It has a market capitalization of nearly $600 billion. As of March 2009, the market capitalization was around $598.3 billion (Rs 30.13 lakh crore) which is one-tenth of the combined valuation of the Asia region.

As noted above, the transformation of the securities market has had numerous significant economic effects. These include the impact of competition; the BSE's total remodeling of itself to meet competition from the NSE; increased access to the market, including from foreign firms, yielding more vigorous competition among securities brokers and mutual funds; entrepreneurs more readily able to access equity financing compared to debt financing; and greater availability of capital inthe economy reflective of the increasing importance of securities markets in resource allocation and the dominance of equity financing. Although reforms in other sectors have not been as dramatic and successful as those in the equity markets, the effectiveness of the equity market reforms has boostedconfidence in reform processes throughout the financial market, strengthening the regulator and building market institutions to improve competition in the sector. Among processes that have been followed in different sectors are, in banking, improved competition and prudential norms in line withinternational norms, increased disclosure levels, and improved autonomy of public sector banks; in insurance, diminished State involvement in the commodities markets, establishment of the Insurance Regulatory and Development Authority (IRDA), and opening the sector to a competitive marketstructure and free market pricing; in the debt market, creation of a clearing corporation for debt market trades (Clearing Corporation of India, Ltd., CCIL), trading interest rate products, and creation of the Negotiated Dealing System (NDS) and its evolution into an electronic limit order book.

Reforms Strengthened Connections to Global Markets

Recent investments in Indian exchanges as well as plans to develop an International Financial Center in India strengthen the connections with global markets. Deutsche Bank (DB) and the Singapore Stock Exchange (SGX) each bought a 5 percent stake in the BSE. The NYSE Group, owner of the NYSE, and three international investment groups — General Atlantic, Goldman Sachs, and Softbank Asi Infrastructure Fund (SAIF) — purchased a 20 percent stake in NSE. The NSE announced early in 2007 that each of these four entities would acquire a 5 percent stake from existing promoters, who are institutions. These alliances bring to India's capital market the extensive resources, experience, andnetworks of some of the world's preeminent financial market groups, groups that are strongly positioned in North America, Europe, and Asia. They will significantly improve NSE's and BSE's strategic positions, reinforce their global ties, and strengthen India's stock exchanges and its capital market. Because the development of technology to run trading platforms is one of the largest expenses of an exchange, the relationship should also help the NSE and BSE, as well as other members of their extended networks, to continually upgrade and maintain technological superiority at a lower cost thanif each had to do so independently. India is also considering ambitious efforts to develop an International Financial Center.

CONCLUSION

The changes in market structure, regulation and technology brought about significant qualitative changes in the Indian securities market, greatly reduced systemic and settlement risks, and helped create more transparent, liquid and efficient securities markets. Increasing confidence in the fairness and efficiency of the market, and the elimination of barriers to foreign institutional investment in 1994, fuelled the growth of foreign portfolio investment.

Market liquidity increased greatly as a function of changes in settlement rules and the introduction of derivatives trading. The NSE introduced trading in equity derivative products in June 2000. It has since become the largest exchange in single stock futures and it ranks fourth globally in the number of stock index futures contracts traded. The move from fixed period to rolling settlements, shortened settlement periods, and a dramatic increase in derivatives trading contributed to steadily increasing market liquidity. The approach of the regulator is to provide more and more products. The approach is to provide simplification and convenience to the investors going forward. The approach is also to encourage corporates to raise money domestically. It is observed that a very large portion of the capital market is concentrated in the eight to ten large cities of India, there will be a need to deepen the access of the capital market to small markets and rural areas.

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