Capital Market Operations and Its Impacts on Indian Economy

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Abstract- **This study analysis the influence of the stock market and debt market on the Indian economy. This analysis of data is multiple regression and ordinary lest squares estimation techniques. The result of the study shows that the Indian capital market has the potentials of growth including but it has not contributed meaningfully to growth of Indian economy. Thus it was concluded and recommend that the Indian capital market and debt market one of the mainstream in every economy that has the power to influence economic growth, hence the government is encourage to encourage to invest in the form of government securities.**

Keywords: Capital Market, Market Capitalization, Economic Growth, Government Securities

1. INTRODUCTION

All long-run growth theories imply that a country can grow faster by investing more, in human or physical capital or in R&D. In the goods market it is assumed that total spending is influenced by the stock market value, current income, fiscal policy and the real exchange rate. It is assumed that the stock market value has a wealth effect and therefore influences consumption and determines the value of capital relative to its replacement costs. In the asset market, the model assumes no arbitrage between short-term bonds and shares such that share value is equated to return on bonds. The model is then analysed for anticipated and unanticipated changes in monetary and fiscal policy assuming fixed and flexible prices. The analysis indicates that a stable set of fiscal policies play an important role in reducing volatility of real exchange rates and equity prices.

The capital market has been identified as an institution which contributes to the socio-economic growth and development of emerging and developed economies. However, the paucity of long-term capital has posed a great challenge to economic development in India. capital market as the driver of any economy to growth and development because it is essential for the long-term growth capital formation. It is crucial in the mobilization of savings and channelling of such savings to profitable self-liquidating investment. The Indian capital market provides the necessary lubricant that keeps turning the wheel of the economy. It does not only provide the funds required for investment but also efficiently allocates these funds to projects of best returns to fund owners. This locative function is critical in determining the overall growth of the economy. The functioning of the capital market affects liquidity, acquisition of information about firms, risk diversification, savings Mobilization and corporate control.

The first section of the study examines a general background of study and set out the significance objectives of the study. It also highlights the need for efficient capital market. The second section, gives the outlook of the past Literature and theory of economic growth. Section three will be on theoretical framework and methodology. Section four examines analyses of the finding. Section five conclusion and recommendations.

2. LITERATURE REVIEW

This study also investigates the existence of seasonality in Indian markets. The study makes use of monthly return data of BSE's sensitivity index for the period ranging from 2016 to 2018. Capital Market of India There has been a wide range of studies concerning financial sector reforms in general, and capital market reforms in particular, since mid-1980s in India. This section highlights certain important studies that are context relevant. Several studies such as Shane (1985), Kothari (1986), Mukherjee (1988), Lal (1990), Chandra (1990), Franscis (1991), Ramesh Gupta (1991,1992), Raghunathan (1991), Varma (1991), Gupta (1992), and Sinha (1993) comment upon the Indian capital market in general and trading systems in the stock exchanges in particular and suggest that the systems therein are rather antiquated and inefficient, and suffer from major weakness and malpractices. According to most of the Indian debt market, recommending necessary measures for the development of the secondary market for debt. It highlights the need to integrate the regulated debt market with the free debt market, the necessity for market making for financing and hedging options and interest rate derivatives, and tax reforms. Cho (1998) points out the reasons for which reforms were made in Indian capital market stating the after reform developments. Shah (1999) describes the financial sector reforms in India as an attempt at developing financial markets as an alternative vehicle determining the allocation of capital in the economy. Shah and Thomas (2003) review the changes which took place on India's equity and debt markets in the decade of the 1990s.

This has focused on the importance of crises as a mechanism for obtaining reforms. Mohan (2004) provides the rationale of financial sector reforms in India, policy reforms in the financial sector, and the outcomes of the financial sector reform process in some detail. Shirai (2004) examines the impact of financial and capital market reforms on corporate finance in India. India's financial and capital market reforms since the early 1990s have had a positive impact on both the banking sector and capital markets. Nevertheless, the capital markets remain shallow, particularly when it comes to differentiating high-quality firms from low-quality ones (and thus lowering capital costs for the former compared with the latter). While some high-quality firms (e.g., large firms) have substituted bond finance for bank loans, this has not occurred to any significant degree for many other types of firms (e.g., old, export-oriented and commercial paper-issuing ones). This reflects the fact that most bonds are privately placed, exempting issuers from the stringent accounting and disclosure requirements necessary for public issues. As a result, banks remain major financiers for both high and low-quality firms. The paper argues that India should build an infrastructure that will foster sound capital markets and strengthen banks' incentives for better risk management.

3. THE FINANCIAL MARKET

The international financial market over the world has grown very fast in the recent years. The private capital market is consistently improving since 1997. The buoyant capital flows among the nation boundaries have raised the existing strength of the financial market domestically as well as internationally. The markets over the world, particularly the financial markets are largely affected by the hedge funds. The use of hedge funds has allowed the trading activities with large number of dealers. Traditionally the banks were involved in the activities of lending and receiving deposits. In the recent years banking sector among the countries over the world are the main area of concerns in the financial activities with rendition of a large number of services.

Banking sector has a major role in developing the financial sector in the rural areas with the result of falling transaction cost on investment. The financial markets can be majorly divided into money and capital market. Money markets are Markets for borrowing and lending money for one years or less. The securities in a money market can be government bonds, Treasury bills and commercial paper from banks and companies. The money market is not a place. It is the continual buying and selling of short-term liquid investments, trading in highly liquid short-term assets and securities, such as Treasury bills and commercial paper. The money market is often, though not always, included in counts of the money supply. One may trade on the money market either on an exchange or over-the counter.

The capital Market on the other hand is a market where both government and companies raise long term funds to trade securities on the bond and the stock market. It consists of both the primary market where new issues are distributed among investors, and the secondary markets where already existing securities are traded. In the capital market, mortgages, bonds, equities and other such investment funds are traded. The capital market also facilitates the procedure whereby investors with excess funds can channel them to investors in deficit. The capital market provides both overnight and long term funds and uses financial instruments with long maturity periods.

4. HISTORICAL BACKGROUND OF THE INDIAN STOCK EXCHANGE

Stock market in India has a long and chequered history. Bombay Stock Exchange, the first stock exchange of the country was established as early as in 1875, predating the Tokyo Stock Exchange by three years. Over these years Indian stock market has passed through diverse fortunes. The historical evolution of Indian stock market through four distinct phases is described in this section. The economic significance of a stock market results from the increased marketability resulting from a stock exchange share quotation. The stock exchange is an essential institution for the existence of the capitalist system of the economy and for the smooth functioning of the corporate form of organisation.

The Securities Contracts (Regulation) Act of 1-956 defines, a stock exchange as "an association, organisation or body of individuals, whether incorporated or not, established for the purpose of assisting, regulating and controlling, business in buying, selling and dealing in securities."

Stock Exchanges are noted as "an essential concomitant of the Capitalistic System of economy. It is indispensable for the proper functioning of corporate enterprise. It brings together large amounts of capital necessary for the economic progress of a country. It is a citadel of capital and pivot of money market. It provides necessary mobility to capital and indirect the flow of capital into profitable and successful enterprises. It is the barometer of general economic progress in a country and exerts a powerful and significant influence as a depressant or stimulant of business activity."

The first organised stock exchange in India was started in 1875 at Bombay and it is stated to be the oldest in Asia. In 1894 the Ahmedabad Stock Exchange was started to facilitate dealings in the shares of textile mills there. The Calcutta stock exchange was started in 1908 to provide a market for shares of plantations and jute mills. Then the madras stock exchange was started in 1920. At present there are 24 stock exchanges in the country, 21 of them being regional ones with allotted areas. Two others set up in the reform era, viz., the National Stock Exchange (NSE) and Over the Counter Exchange of India (OICEI), have mandate to have nation-wise trading.

They are located at Ahmedabad, Vadodara, Bangalore, Bhubaneswar, Mumbai, Kolkata, Kochi, Coimbatore, Delhi, Guwahati, Hyderabad, Indore, Jaipur’ Kanpur, Ludhiana, Chennai Mangalore, Meerut, Patna, Pune, Rajkot. The Stock Exchanges are being administered by their governing boards and executive chiefs. Policies relating to their regulation and control are laid down by the Ministry of Finance. Government also Constituted Securities and Exchange Board of India (SEBI) in April 1988 for orderly development and regulation of securities industry and stock exchanges

5. THE IMPORTANCE OF THE CAPITAL MARKET TO THE DEVELOPMENT OF THE INDIAN ECONOMY

The capital market is a network of specialized financial institutions, series of mechanisms, processes and infrastructure that, in various ways, facilitate the bringing together of suppliers and users of medium to long term capital for investment in socioeconomic developmental projects”. The capital market is divided into the primary and the secondary market. The primary market or the new issues market provides the avenue through which government and corporate bodies raise fresh funds through the issuance of securities which is subscribed to by the general public or a selected group of investors. The secondary market provides an avenue for sale and purchase of existing securities.

The roles of the capital market in the development of the economy include:

(1) It provides opportunities for companies to borrow funds needed for long-term investment purposes.

(2) It provides avenue for the marketing of shares and other securities in order to raise fresh funds for expansion of operations leading to increase in output/production.

(3) It provides a means of allocating the nations real and financial resources between various industries and companies. Through the capital formation and allocation mechanism the capital market ensures an efficient and effective distribution of the scarce resources for the optimal benefit to the economy.

(4) It reduces the over reliance of the corporate sector on short term financing for long term projects and also provides opportunities for government to finance projects aimed at providing essential amenities for local investors.

(5) The capital market can aid the government in its privatization programme by offering her shares in the public enterprises to members of the public through the stock exchange.

(6) The capital market also encourages the inflow of foreign capital when foreign companies or investors invest in domestic securities, provides needed seed money for creative capital development and acts as a reliable medium for broadening the ownership base of family-owned and dominated firms.

6. METHODOLOGY OF THE STUDY

6.1. Model Specification

Using a production function approach, it states that the growth rate of output (GNP) is principally determined by the following factors:- The rate of growth of gross labour multiplied by the labour income share. The rate of growth of gross capital input multiplied by the capital income share; and Change in technology. Thus, this is given as: g = f (L,K,T) (i) g = Growth of GDP L = Labour K = Capital formation/Investment T = Technology.

6.2. Estimation Technique

Regression analysis of the ordinary least square is use in this study to test the relationship between the stock market and economic growth measured by the numbers of independent variables offers by the markets, which are gross capital formation (public investment), foreign direct investment, capital market index debt overhang, proxied by export minus GDP ratio. This study focuses on the indian stock market between the periods 2016 to 2017. Equation (iii) will be estimated using ordinary lease squares technique (OLS). The equation will also be subjected to a dynamic estimation, using the lagged structure of the variables.

6.3. Sources of Data

Secondary data are used in this study. The data were collected from the Bombay Stock Exchange (BSE) National Stock Exchange (NSE), Fact Books, Security and Exchange Commission (SEC). The data are empirically analyzed and results are discussed, data covering the period of 2016 – 2018.

7.1. Findings

From the result so far, it is obvious clear that the variables in the model were highly correlated and have a significant impact on growth rate of gdp. The estimated model is a good one with desirable characteristics and the impact of capital formation on economic growth and development has been established to depend on the government securities invest in long term. It can also be concluded from the result that there is significant impact on the government securities and gross capital formation while there is significant impact between government securities and foreign direct investment.

CONCLUSION

Findings shows that the capital market impact on economic growth via market capitalization, market index, value of transaction and total listing of equity and government stock. As it was observed market capitalization, government stock and value of transaction are important capital market variables that are capable of influencing economic growth. Hence the capital market remain one of the mainstream in every economy that has the power to influence or impact economic growth therefore the organized private sector is to invest in it. The market capitalization have not impact significantly on the GDP while volume of transaction and total listed equities and Government stock have significant impact on the GDP. The government is therefore advised to put up measures to stem up investors' confidence and activities in the market and more foreign investors should be encouraged to participate in the market for improvement in the declining market capitalization so that it could contribute significantly to the Indian economic growth.

RECOMMENDATIONS

In order for the Indian capital market to be a pivotal force in Indian socio-economic growth and development and encouragement of local investment, the following suggestions are put forward: 1.First, improvement in the declining market capitalization by encouraging more foreign investors to participate in the market, maintain state of the art technology like automated trading and settlement practices, electronic fund clearance and eliminate physical transfer of shares.

2. There is also need to restore confidence to the market by regulatory authorities through ensuring transparency and fair trading transactions and dealings in the stock exchange. It must also address the reported cases of abuses and sharp practices by some companies in the market.

3. Moreover, the total listing in the BSC and NSE is still a far cry compared to other stock exchanges like South Africa and Egypt. Therefore, to increase the number of listed companies there is need to ensure stable macroeconomic environment, encourage both local and foreign multinational companies (MNCs) or their subsidiaries to be listed on the Nigerian Stock Exchange, relax the listing requirements to the first tier market and ensure tax rationalization in the capital market to encourage quotation and public interest in shareholdings. For new issues, increase the minimum equity capital requirements for companies other than banks, insurance companies and other financial institutions, encourage merger and consolidation, discriminatory income tax in favour of public quoted companies and aggressive enlightenment programme to increase awareness of the benefits of investing in the stock market and seeking quotation at the stock exchange.

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