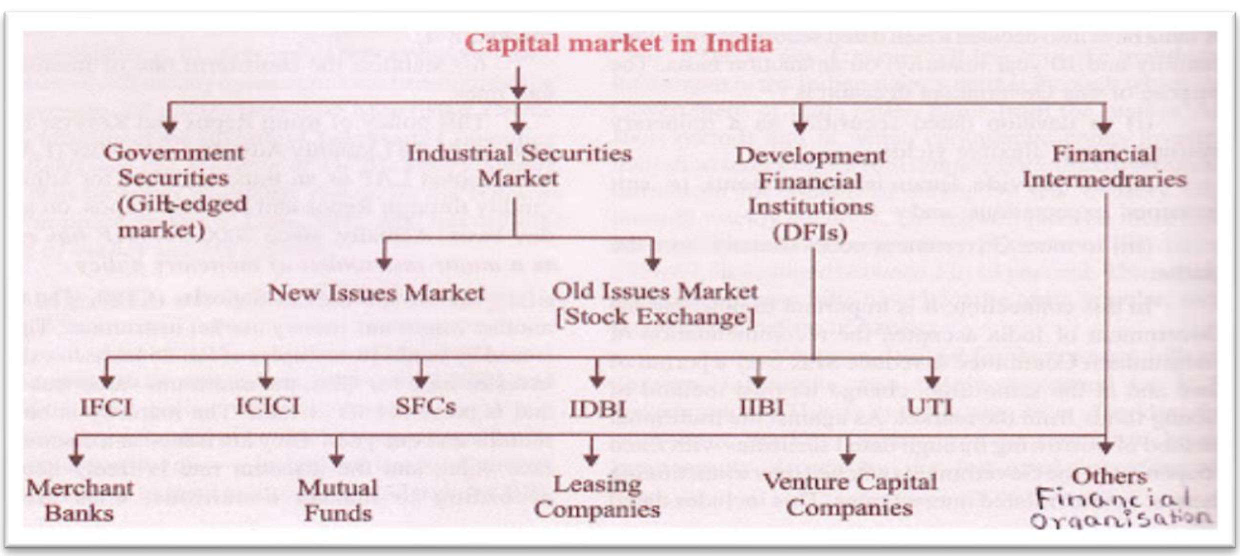
PUJA AGARWAL
Assistant Professor (Guest Faculty)
Department of Economics
Bihar National College, Patna University
E-Mail : pujaagarwal03@yahoo.com

M.A. Economics – Semester IV
EC-1 (Group- G) : Financial Economics- I
(Module- IV)

CAPITAL MARKET

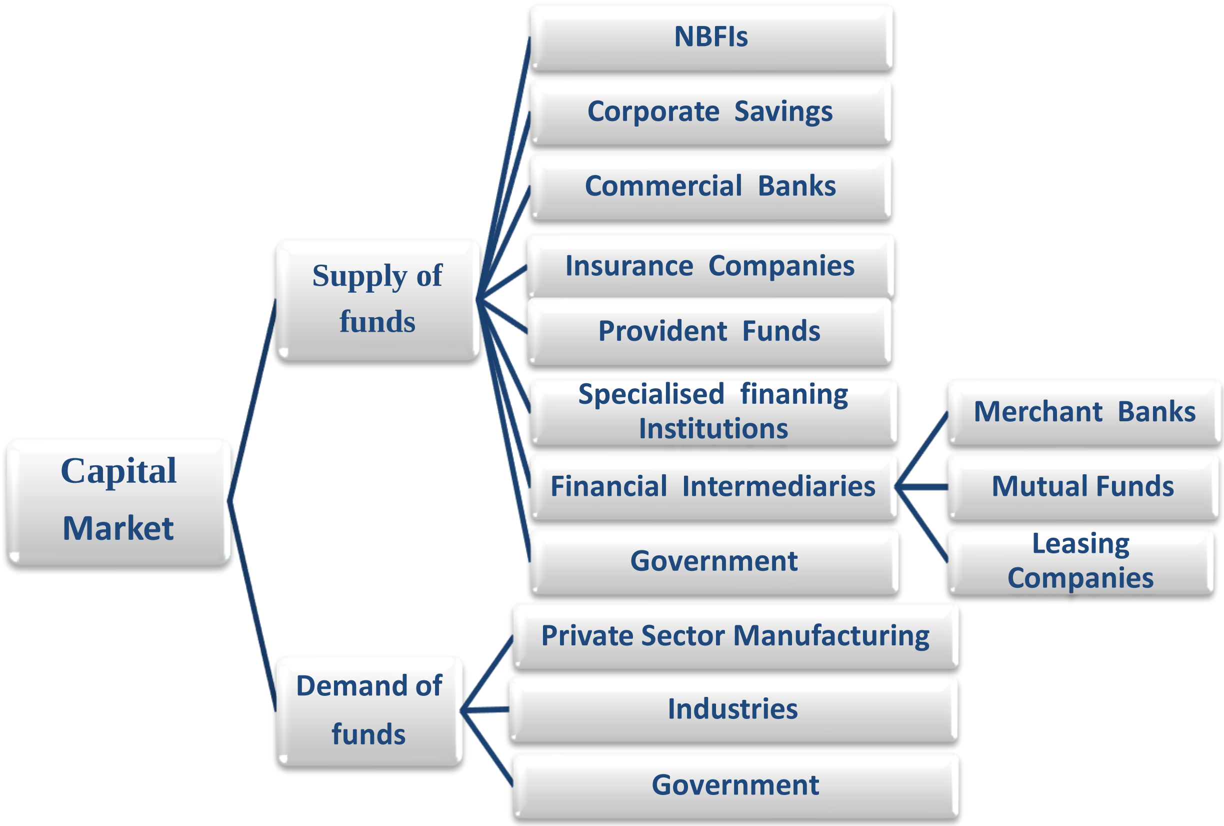
Capital markets are a sub-market of the financial system. It is the market for long-term funds, just as the money market is the market for short-term funds. Capital market deals in financial instruments and commodities like bonds, stocks, shares, securities, debentures, etc. They have a maturity of at least more than more than one year. These also differ in nature, maturity, interest rate, dividend, liability, ownership etc. Capital markets channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments. It does not deal in capital goods but is concerned with raising of money capital for purpose of investment.

Composition / Structure of Capital Market in India



An ideal capital market attempts to provide adequate capital at reasonable rate of return for any business or industrial proposition which offers a prospective yield high enough to make borrowing worthwhile.

Supply and Demand of Funds for the Capital Market



Importance or Functions of Capital Market

- The capital market helps in mobilizing savings and supplying funds to investors so as to make productive investments for the development of commerce and industry .

- The capital market acts as an important link between savers and investors. As such, it provides incentives to savers in the form of interest or dividend and transfers funds to investors.

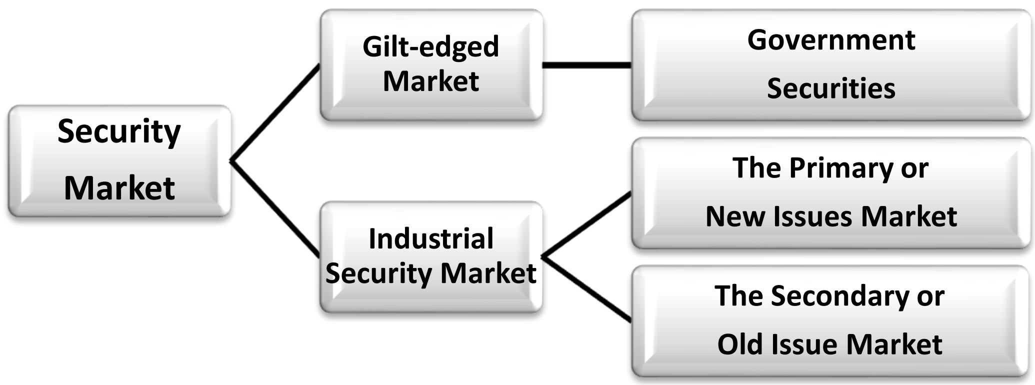
- The capital market diverts resources from wasteful and unproductive channels such as gold, jewellery, real estate, etc. to productive investments.

- A well-developed capital market comprising expert banking and non-banking intermediaries brings stability in the value of stocks and securities.

- The capital market not only aims to bring rational allocation of resources but also economic growth as a whole.

Security Market

On the basis of instruments or securities, the capital market in India is divided into the gilt-edged market and industrial security market.



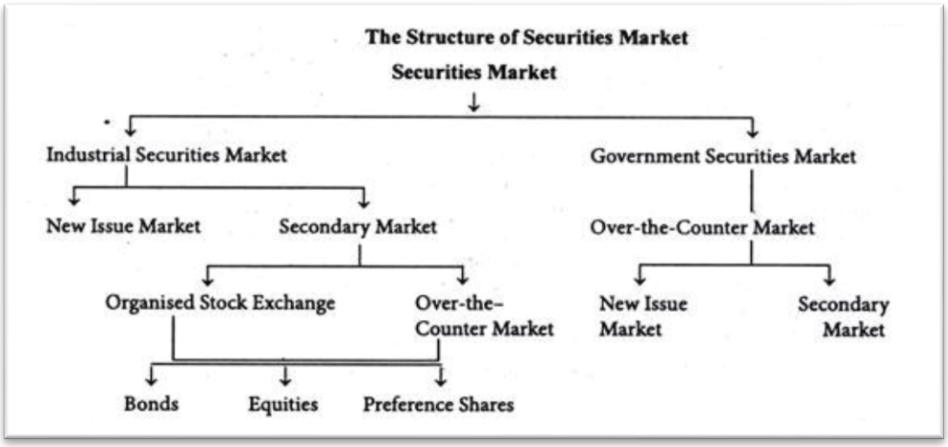
Gilt-edged Market

It is the market for Government and semi-government securities. Central and State Governments and local bodies sell long-term bonds or securities to the public, banks and financial institutions. These bonds are backed by the RBI.

- There are no uncertainties regarding yield, management, additions to capital, etc. and therefore there is much less speculation in this market.
- The investors in government securities are predominantly institutions which are often compelled by law to invest a certain portion of their funds in these securities. The commercial banks, the LIC, the GIC and the provident funds come under this category.
- Securities traded are less risky, more safer and highly stable in value. Infact, these are more liquid than industrial securities.
- These attract more investors because they carry a variety of tax incentives and rebates on income tax and wealth tax.
- The average value of the transaction in the Government securities market is much larger than in case of shares and debentures of companies.
- The Government securities market, unlike the market for shares, is not an auction market but an "over the counter" market.
- Finally, RBI plays a dominant role in the gilt-edged market through its open-market operations.

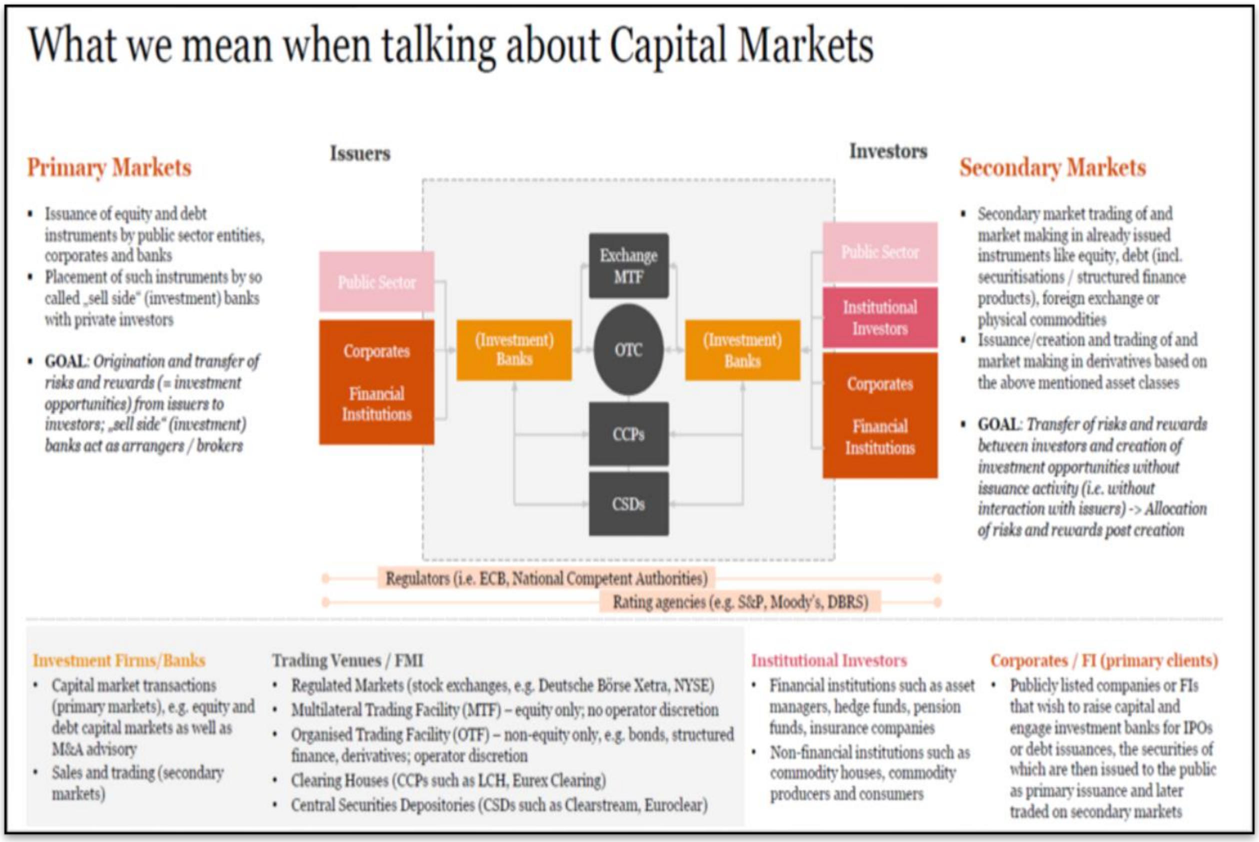
The Industrial Securities Market

The Industrial Securities Market refers to the market for shares and debentures of old and new companies of commercial, finacial and industrial concerns. This market is further divided into the new issue and the old issue market meaning the stock exchange.



(i) ***The Primary or New Issues Market.*** The primary capital market is for new issues by public limited companies in the form of new capital issues directly to the public in the form of share and debentures. Capital is also raised by companies in the primary market by private placement whereby shares are also sold to specific group of investors such as relatives, friends and holders of shares of the same industrial group or house. Merchant bankers, mutual funds, commercial banks and other financial institutions operate as underwriters and lead managers. The help in mobilising the savings of the public in new issues market and channelising them into productive uses by trade and industry.

(ii) ***The Secondary or Old Issues Market.*** The secondary capital market, commonly known as the stock market deals in various types of shares and debentures at the stock exchanges. They are actively traded by brokers, mutual funds and NBFIs like the UTI, GCI, etc. Stock market is managed and regulated by the Securities and Exchange Board of India (SEBI). As of now, there are 23 SEBI approved Stock Echanges in the country. However, the two most popular and largest stock exchanges in India are Bombay Stock Exchange (BSE) and National Stock Exchnge (NSE).



<u>Developmental Financial Institutions (DFIs)</u>

A Development financial institution is defined as an institution promoted or assisted by the government to provide development finance to sectors of the economy. In other words, a DFI is a financial agency that provides medium and long-term financial assistance and engaged in promotion and development of industry, agriculture and other sectors.

Forms and Types of DFIs in India

DFIs can be broadly categorized as all-India or state/regional level institutions depending on their geographical coverage of operation.

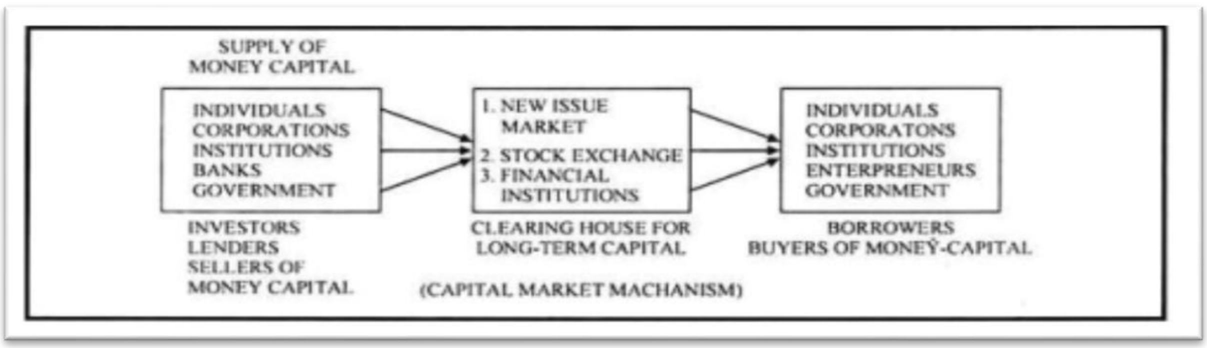
Functionally, all-India institutions can be classified as:

- ***Term-lending institutions*** (IFCI Ltd., IDBI, IDFC Ltd.) extending long-term finance to different industrial sectors,
- ***Refinancing institutions*** (NABARD, SIDBI, NHB) extending refinance to banking as well as non-banking intermediaries for finance to agriculture, SSIs and housing sectors,

➢ ***Sector-specific/specialized institutions*** (EXIM Bank, TFCI Ltd., REC Ltd., HUDCO Ltd., IREDA Ltd., PFC Ltd., IRFC Ltd.) and

➢ ***Investment institutions*** (LIC, UTI, GIC, IFCI Venture Capital Funds Ltd., ICICI Venture Funds Management Co. Ltd.).

State/regional level institutions are a distinct group and comprise various SFCs, SIDCs and NEDFi Ltd.



Rationale of DFIs in India

- Improving Rates of Savings and Investments
- Infancy Stage of Capital Market
- Risk Averse Commercial Bank
- Arrangement of Loan in Foreign Currency
- Specialized Credit Support System
- Arrangement of Priority Sector Financing
- Project Evaluation and Funding
- Coordinating Financing Agencies

Note : ***Industrial Finance Corporation of India (IFCI) is India's first development finance institution set up on July 1, 1948 under the Industrial Finance Corporation Act, 1948 as a statutory corporation to pioneer industrial credit to medium and large scale industries.***

Financial Intermediaries

Mechant Banking – Merchant banks in India manage and underwrite new issues; they undertake syndication of credit; they advise corporate clients on fund raising and other financial aspects. Initially, commercial banks set up merchant banking divisions, which later became separate banking subsidiaries.

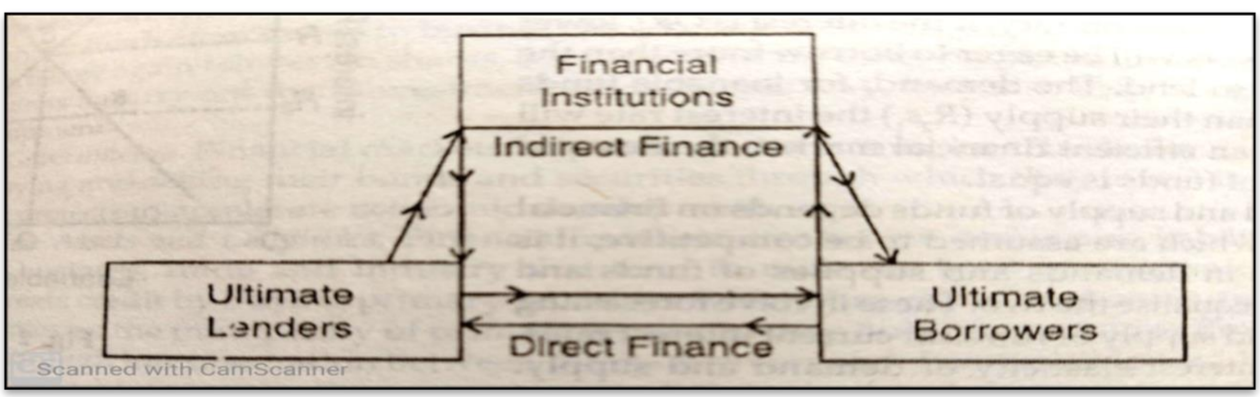
Leasing and hire-purchase companies – Leasing has proved a popular financing method for acquiring plant and machinery, especially for small and medium sized enterprises. Narashimam Committee recognized the important and growing role of leasing and hire-purchase companies in the financial intermediation process.

Mutual funds – Mutual funds are professionally managed fund, which pools investment from several investors to invest in capital assets. Mutual funds also give small or individual investors access to diversified, professionally managed portfolios at a low price. In recent years, mutual funds are subjected to be one of the most important among the newer capital market institutions.

Venture Capital Funds – Venture capital is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. Venture capital financing is one of the more recent entrants into the capital market. Venture capital generally comes from well-off investors, investment banks and any other financial institutions.

Working of Indian Capital Market

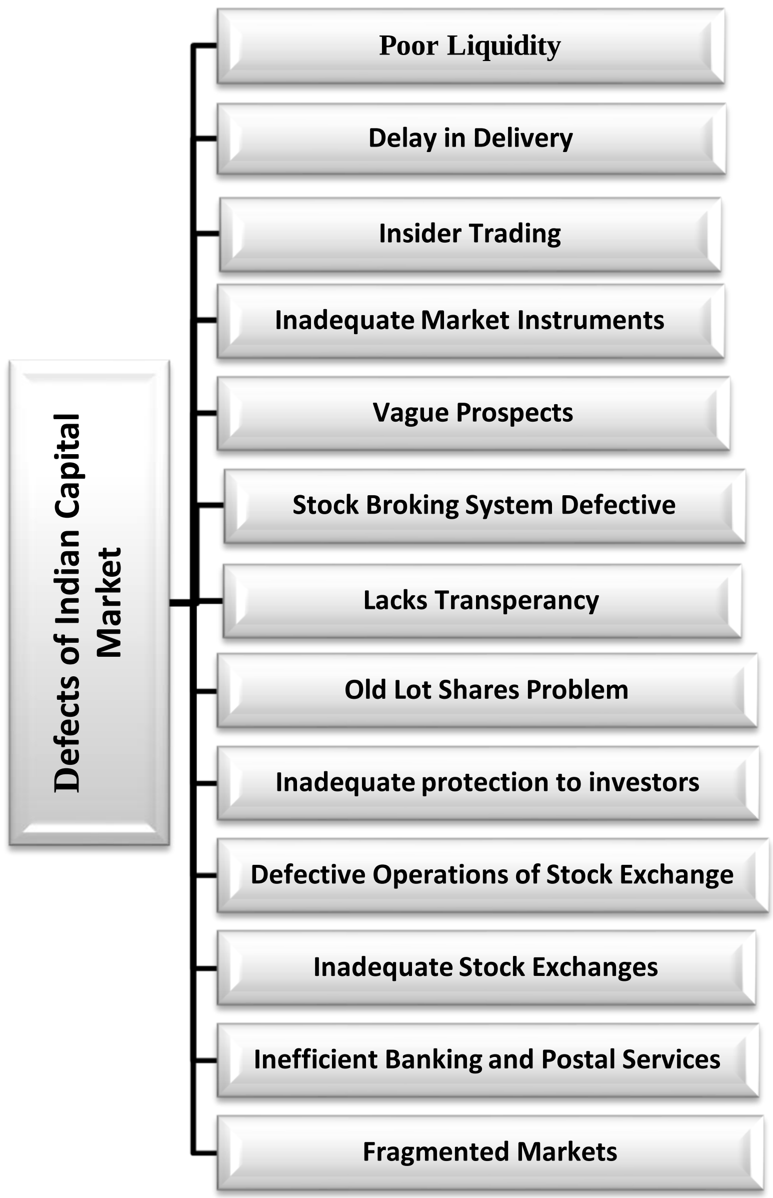
India is one of the few countries among the developing nations where the Bombay Stock Exchange began to function as early as in 1874, where the Government securities and bonds issued by Port Trust Municipal Corporation etc. were traded.



Financial Intermediaries, FIs function as dealers by buying funds from ultimate lenders in exchange for their own secondary securities and selling funds to ultimate borrowers in exchange for the latter's primary securities.

The Securities and Exchange Board of India (established in 1988 and given statutory powers on 30 Jan 1992 through the SEBI Act,1992) is the regulator of the securities and commodity market in India .

Defects of Indian Capital Market



Suggested Readings:

Bhole, L.M. (1999). *Financial Institutions and Markets,* Tata McGraw Hill Company Ltd., New Delhi

Datt,G. & Mahajan,A. (2012). *Indian Economy,* S. Chand, Revised Sixty Sixth Edition

Gupta,S.B. (2009). *Monetary Economics Institutions, Theory and Policy,* S. Chand

Smith, P.F. (1978). *Money and Financial Intermediation: The Theory and Structure of Financial System,* Prentice Hall & Englewood-Cliff, New Jersey