

# INDIAN FINANCIAL MARKETS: AN INTRODUCTION

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## Abstract :

Financial markets create an environment that helps people trade money for financial assets such as equity shares or commodities like gold or other precious metals. There are different players in the market who take charge of matching capital supply and demand. Investors, both individual and institutional, provide capital to the market in anticipation of returns as promised by the borrowers or users of capital. Banks and other financial intermediaries facilitate the movement of capital between lenders and borrowers. Securities market consists of various financial institutions that collectively support the issuance and trading of securities. These are various channels that create assets pools such as mutual funds and pension funds. Financial markets facilitate allocation of resources over time through a price mechanism such as interest rate, which is affected by forces of supply and demand. In market economies, the interactions between buyers and sellers determine the demand for and supply of resources. Thus the allocation of resources is determined by market forces. In view of this the present paper through the light on introductory aspects relating to Indian Financial Market.

The globalizations several of the erstwhile command economies, which were driven by the plans prescribed by their respective government, have apparently moved towards market economies. Today, the global financial markets are well integrated and harmonization of the rules and regulations and reduction of barriers to trade have been facilitating free flow of resources between nations as result local companies had to come out their protective cover, provided by the government. The corporate are compete for their share of market and resources in the global arena. The developing countries have become highly vulnerable to the speculative capital movements in and out of their economies, several of the emerging markets are able to consolidate or improve their competitive position by exploiting the newly created opportunities, by virtue of this several companies from the emerging markets are industry leaders and global market players.

## Introduction :

Capital market is the backbone of any country's economy. It facilitates conversion of savings to investments. Capital market can be classified as primary and secondary market. The fresh issue of securities takes place in primary market and trading among investors takes place in secondary market. Primary market is also known as new issues market. Equity investors first enter capital market through investment in primary market. The capital market is a system or framework, which facilitates savings and investment. The securities markets provide channels for the allocation of savings to investments. Through the capital market:

- Companies can raise resources from the people or investors.
- Households can invest their savings in industrial or commercial activities to earn a return.

Hence, the capital market is a mechanism by which capital (funds) moves from those with surplus funds (investors) to those in need of funds (companies) Savings are linked to investments through a range of financial products called securities. Market-oriented economic reforms in India began at the beginning of the 1990s. The removal of many administrative controls on bank credit and the primary market for securities (mostly equities) since then have resulted in the equity capital markets playing a much more significant role in shaping resource allocation in India. Till 1994, equity trading in India was dominated by floor-trading on the Bombay Stock Exchange ("BSE"). The ills of floor-trading were abundant and included zero transparency and extremely limited liquidity. These resulted in artificial pricing of securities, leaving investors with high exposure to risk. Membership to the BSE was closed and corporate entities and foreign brokerage firms were barred entry, resulting in high brokerage fees for investors.

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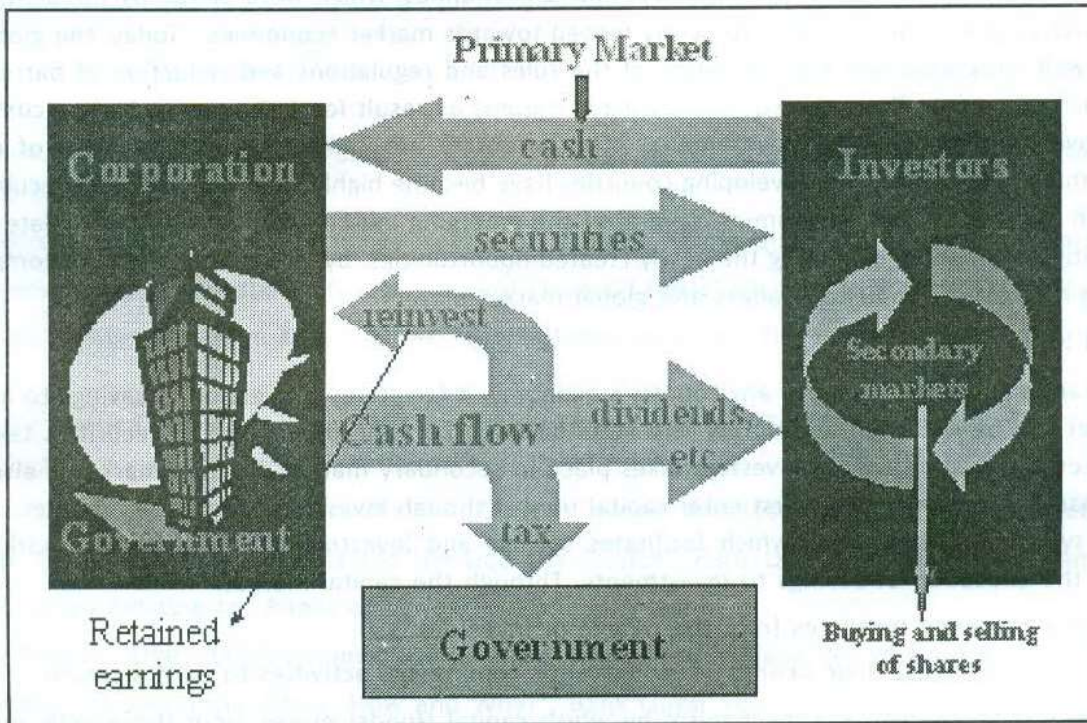
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Further, the primitive state of telecommunications, coupled with the floor-trading system, resulted in a limited investor base, all concentrated in the Bombay area. This lack of market access exacerbated the illiquidity. In 1994, a consortium of government-owned financial institutions started the National Stock Exchange ("NSE"). The NSE built a state-of-the-art electronic order-matching system that was fully automatic. The system used satellite communications and made nationwide access a reality. The NSE formed itself as a limited liability corporation that franchised out to brokerage firms. This is a standard international organizational structure that discourages restricted membership.

The NSE also admitted corporate entities and foreign brokerage firms. The NSE became India's largest exchange and displaced the entrenched. Capital markets in India can be broadly classified in to Primary and Secondary markets.

**Primary Market :**

A primary market is one in which a borrower issues new securities in exchange for cash from an investor (buyer). New sales of Treasury bills, . If the issuer is selling securities for the first time, these are referred to as initial public offers. Once the original purchasers sell the securities, they trade in secondary markets. New securities may trade repeatedly in the secondary market, but the original issuers will be unaffected in the sense that they receive no additional cash from these transactions.



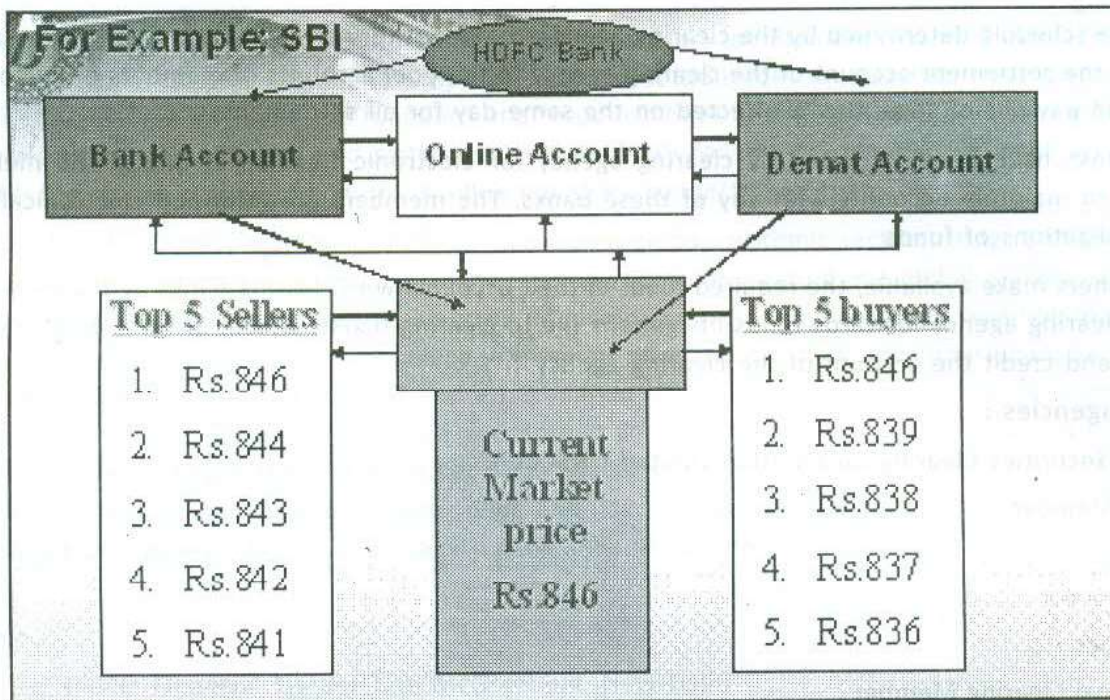
**Why do companies need to issue shares to the public?**

- Most companies are usually started privately by their promoter(s).
- Promoter(s) and the borrowings from banks and financial institutions may not be sufficient for setting up or running the business over a long term.
- So the companies invite the public to contribute towards the equity and issue shares to individual investors/ corporate/ HNI and etc.

Once new securities have been sold in the primary market, an efficient mechanism must exist for their resale if investors are to view securities as attractive opportunities. Secondary markets give investors the means to trade existing securities.

**1.3. The secondary market :**

The secondary market is the financial market for trading of securities that have already been issued in an initial private or public offering. Alternatively, secondary market can refer to the market for any kind of used goods. The market that exists in a new security just after the new issue is often referred to as the aftermarket. Once a newly issued stock is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock.



In the secondary market, securities are sold by and transferred from one investor or speculator to another. It is therefore important that the secondary market be highly liquid and transparent. Before electronic means of communications, the only way to create this liquidity was for investors and speculators to meet at a fixed place regularly. This is how stock exchanges originated. Secondary marketing is vital to an efficient and modern capital market. Fundamentally, secondary markets interlock the investor's preference for liquidity with the capital user's preference to be able to use the capital for an extended period of time.

Traditional loan allows the borrower to pay back the loan, with interest, over a certain period. For the length of that period of time, the bulk of the lender's investment is inaccessible to the lender, even in cases of emergencies. Likewise, in an emergency, a partner in a traditional partnership is only able to access his or her original investment if he or she finds another investor willing to buy out his or her interest in the partnership. With a securities loan or equity interest (such as bonds) or tradable stocks, the investor can sell, relatively easily, his or her interest in the investment, particularly if the loan or ownership equity has been broken into relatively small parts. This selling and buying of small parts of a larger loan or ownership interest in a venture is called secondary market trading.

**Clearing and Settlement :**

The clearing and settlement mechanism in Indian securities market has witnessed significant changes and several innovations during the last decade. The stock exchanges in India were following a system of account period settlement for cash market transactions. T+2 rolling settlement has been introduced for all securities since 2001. Movement of securities has become almost instantaneous in the dematerialized environment. Two depositories viz., National Securities Depositories Ltd. (NSDL) and Central Depositories Services Ltd. (CDSL) provide electronic transfer of securities and more than 99% of turnover is settled in dematerialized form. All actively traded scripts are held, traded and settled in DEMAT form.

**The process :**

- The obligations of members are downloaded to members of custodians by the clearing agency
- The members or custodians make available the required securities in their pool accounts with depository participants (DPs) by the prescribed pay-in time for securities
- The depository transfers the securities from the pool accounts of members or custodians to the settlement account of the clearing agency
- As per the schedule determined by the clearing agency, the depository transfers the securities on the payout day from the settlement account of the clearing agency to the pool accounts of members or custodians. The pay-in and pay-out of securities is effected on the same day for all settlements
- Select banks have been informed by clearing agency for electronic transfer of funds. The members are required to maintain accounts with any of these banks. The members are informed electronically of their pay-in obligations of funds

The members make available, the required funds in their accounts with clearing banks by the prescribed pay-in day. The clearing agency forwards funds obligations file to clearing banks, which, in turn, debit the accounts of members and credit the account of the clearing agency.

**Settlement agencies :**

- National Securities Clearing Corporation Limited ( NSCCL )
- Clearing Members
- Custodians
- Clearing Banks
- Depositories
- Professional Clearing Member

**National Securities Clearing Corporation Limited (NSCCL) :** The NSCCL is responsible for post-trade activities of a stock exchange. Clearing and settlement of trades and risk management are its central functions. It clears all trades, determines obligations of members, arranges for pay-in of funds or securities, receives funds or securities, processes for shortages in funds/securities, arranges for pay-out of funds/securities to members, guarantees settlement, and collects and maintains margins

**Clearing Members :** They are responsible for settling their obligations as determined by the NSCCL. They have to make available funds and/or securities in the designated accounts with clearing bank/depository participant, as the case may be, to meet their obligations on the settlement day. In the capital market segment, all trading members of the Exchange are required to become the Clearing Member of the Clearing Corporation.

**Custodians :** A custodian is a person who holds for safekeeping the documentary evidence of the title to property belonging like share certificates, etc. The title to the custodian's property remains vested with the original holder, or in his nominee. He settles trades assigned to him by trading members. He is required to confirm whether he is going to settle a particular trade or not. If it is confirmed, the NSCCL assigns that obligation to that custodian and the custodian is required to settle it on the settlement day. If the custodian rejects the trade, the obligation is assigned back to the trading / clearing member.

**Clearing Banks :** Clearing banks are a key link between the clearing members and NSCCL for funds settlement. Every clearing member is required to open a settlement account with one of the clearing banks. Based on his obligation as determined through clearing, the clearing member makes funds available in the clearing account for the pay-in and receives funds in case of a payout. Multiple clearing banks provide advantages of competitive forces, facilitate introduction of new products namely, working capital funding, anywhere banking facilities, the option to members to settle funds through a bank, which provides the maximum services suitable to the member.

**Depositories :** A depository is an entity where the securities of an investor are held in electronic form. The person who holds a demat account is a beneficiary owner. In case of a joint account, the account holders will be beneficiary holders of that joint account. Depositories help in the settlement of the dematerialized securities. Each custodian/clearing member is required to maintain a clearing pool account with the depositories. He is required to make available the required securities in the designated account on settlement day. The depository runs an electronic file to transfer the securities from accounts of the custodians/clearing member to that of NSCCL.

**Professional Clearing Member :** NSCCL admits special category of members namely, professional clearing members. Professional Clearing Member (PCM) may clear and settle trades executed for their clients (individuals, institutions etc.). In such an event, the functions and responsibilities of the PCM would be similar to Custodians. PCMs may also undertake clearing and settlement responsibility for trading members. In such a case, the PCM would settle the trades carried out by the trading members connected to them.

**Rolling settlement :** Capital markets are in the midst of a global, systemic restructuring. Communication and technology have enabled individual financial markets to link together creating one global market. Internationally, retail and institutional investors have been empowered leading to a more dynamic and sensitive market. The use of technology has enabled the investor populace to discount news more quickly and comprehensively. Technology has also enabled the formation of a larger and a fair market place. This platform has been a launching pad for the exponential growth in volumes showing a widespread and diverse interest in the securities market. As the volume of securities trading in the global market place has increased in the recent years, the need for shortening the settlement and clearance cycle as a cost saving and risk management discipline has become critical to the orderly conduct of business. As a result many jurisdictions around the world are adopting shorter settlement cycles.

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