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# Analyzing the Advancement of Capital Markets in India: A Research Perspective

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**Abstract: The Indian capital market began trading securities of East Indian companies in the eighteenth century. Since the 1890s, it has been a crucial support for the economy. The capital market plays a significant role in wealth distribution and economic development in India by channeling savings into investments. Following the New Economic Policy of 1991, the capital market has undergone substantial transformation. The Indian government and SEBI have introduced reforms to enhance stock market performance. Capital markets enable companies to raise medium- and long-term funds through individual savings, banks, financial institutions, government entities, and corporations. Households have increasingly invested in safe, low-yielding, and fixed-return financial securities.**

**Investors should be financially literate and knowledgeable about various investment opportunities to avoid losses from unsuitable products. The capital market impacts national economic development. Foreign institutional investors stimulate the financial markets of developing countries, particularly India. This article examines types of capital markets, their history, their role in the economy, the establishment of a sustainable capital market, and the impact of COVID-19 on the Indian stock market.**

**Keywords: COVID-19, Indian capital market, National economic development, New economic policy.**

## I. Overview of the Capital Market

Investors engage in trading stocks, bonds, currencies, and other financial assets within capital markets. Stock and bond markets serve as platforms for entrepreneurs to launch and expand businesses. They also enable individuals to save and invest for the future. Capital markets involve both suppliers and users of funds. Suppliers include households through bank savings accounts, pension and retirement funds, life insurance firms, charitable organizations, and non-financial businesses with excess funds. Users of capital market funds include home and vehicle buyers, non-financial businesses, and government entities supporting infrastructure development and operational expenses. Capital markets primarily deal in equity and debt securities. Stocks represent ownership stakes in companies, while bonds are interest-bearing debt instruments.

## II. Types of Capital Markets

### *A. Primary Market*

During an initial public offering (IPO), a company offers new stocks or securities in the primary capital market, also known as the new issues market. The company engaging in the IPO typically hires an underwriting firm to analyze it and prepare a prospectus detailing pricing and other relevant information. All aspects of primary market offerings are closely regulated. Companies must file statements with the SEC and other securities regulators and await approval before going public. Small investors are generally unable to purchase securities in the primary market because the company and its underwriters must quickly sell all available securities to meet demand, typically targeting large investors who can purchase significant volumes at once.

### *B. Secondary Market*

The SEC-regulated secondary market facilitates the trading of securities among investors. Issuing companies do not participate in secondary market transactions. Examples of secondary markets include the NYSE and NASDAQ, which operate auction and dealer markets. In auction markets, an open outcry system brings together buyers and sellers to disclose their securities prices, with the NYSE being a prominent example. On the other hand, dealer markets utilize electronic networks. Many small investors prefer dealer marketplaces for their transactions.

## III. Evolution of India's Capital Markets: A Historical Perspective

In the seventeenth century, India's capital market commenced trading East India Company securities. Throughout the nineteenth century, securities trading remained erratic, with Bombay and Calcutta emerging as primary trading hubs. Bombay specifically thrived as a center for bank share trading. During the Indian Mutiny of 1857-1858, Bombay saw increased trading activity, particularly in cotton, which drove up share prices. This initial boom in the Indian stock market lasted for five years. The first joint-stock company was established in 1850, marking a significant milestone. However, this period of growth came to an abrupt end on July 1, 1865, when share prices plummeted.

Following independence, the capital market remained subdued. The government prioritized agriculture and public sector initiatives during the first and second five-year plans. Public-sector entities had higher paid-up capital compared to private firms but were not listed on stock exchanges. The Controller of Capital Issues (CCI) rigorously monitored and regulated aspects like timing, company details, interest rates, pricing, allocation, and flotation costs for new issues. These stringent requirements dissuaded many companies from going public for nearly 45 years.

In the 1950s, analysts favored companies such as Century Materials, Tata Steel, Bombay Dyeing, Public Rayon, and Kohinoor Mills. As speculation grew, the stock market transformed into a speculative market. Defaults were rare despite the speculative activity. The Securities Contracts (Regulation) Act of 1956 established a framework for the development of financial institutions and state economic organizations.

## IV. Insights into India's Financial Landscape - Capital Markets in India

India's economic growth has shaped the capital market, leading to the expansion of numerous stock exchanges and intermediaries, listed stocks, market capitalization, trading volumes and turnover, market instruments, investor demographics, issuer profiles, and intermediary roles.

The capital market primarily deals in debt and equity instruments, pooling funds to meet financing requirements for public and commercial enterprises. Exchange-traded derivatives such as options and futures enable investors to hedge and manage risk.

From 1995 to 2005, India's debt and equity markets expanded from 75% to 130%. However, growth compared to the US, Malaysia, and South Korea has been modest and uneven, highlighting substantial potential. India's debt market encompasses government and corporate securities issued by PSUs, corporations, financial institutions, and banks.

India possesses advanced stock exchange and derivatives market frameworks, significant retail participation, and robust liquidity compared to other emerging nations.

## V. Evolution and Development of the Indian Capital Market

### *A. Expansion of Financial Intermediation*

The Indian capital market has advanced through improvements in indirect financing mechanisms, leading to increased financial intermediation. This progress has facilitated the flow of capital from savers to users through new financial intermediaries such as UTI, LIC, and GIC. LIC, for instance, has initiated household savings collections to establish a "life fund," part of which is invested in company shares and debentures. UTI, historically a major stakeholder in one out of every three listed companies until 1991, has offered units to invest household funds in blue-chip company securities.

Financial intermediaries like LIC, UTI, and GIC have significantly contributed to the growth of the Indian capital market, as indicated by the rising intermediation ratio. This ratio compares the volume of secondary securities issued by financial institutions to primary securities issued by non-financial enterprises, which increased from 0.27 in 1951-56 to 0.37 in 1979-80-1981.

### *B. Growth in Underwriting of Securities*

Institutional mechanisms overseeing the issuance of new securities regulate the New Issue Market segment of the capital market. Before independence, securities underwriting was limited due to the absence of institutional support, involving banks and stockbrokers. However, with the advent of specialized financial institutions like LIC, UTI, and established banks such as ICICI, IDBI, and IFCI, the volume and frequency of securities underwriting have significantly expanded in recent years. The fact that 55% of securities were underwritten in 1960-61 compared to 95% today illustrates this growth.

### *C. Growth of Merchant Banking*

In India's capital market, merchant banking commenced in 1969 when Grindlays Bank established a dedicated "Merchant Banking" division. Since then, all commercial banks have incorporated a "Merchant Banking Division" to play a crucial role. These divisions assist companies in evaluating project financial, economic, and technical feasibility. Their initial groundwork sets the investment climate, advising companies on whether public offerings will be fully subscribed or undersubscribed. Indian merchant banks underwrite and manage new securities issuances, overseen by SEBI for all issue-related activities. Merchant banking has strengthened the institutional framework of India's capital market.

### *D. Expansion of Credit Rating Agencies*

Credit rating agencies have emerged in finance relatively recently, playing a crucial role in the growth of the Indian capital market. ICRA evaluates securities, debentures, preference shares, bonds, and commercial papers (CPs). A pioneer in credit rating, Credit Rating Information Services of India Ltd. (CRISIL) rates bank, financial, and corporate debt instruments. The assessment of securities issuers' creditworthiness enhances the New Issue Market segment of the capital market.

### *E. Expansion of Mutual Funds*

Venture funds refer to mutual funds that raise funds from individual and institutional investors in exchange for units redeemable at their Net Asset Value after a lock-in period. These programs offer buyback options and tax incentives. The Unit Trust of India (UTI) pioneered mutual funds in India, followed by commercial banks launching their own schemes like Canara Bank's Can-stock and LIC's Dhana Shree, Raksha, and Riddhi mutual funds.

Mutual fund schemes contribute to capital market growth by pooling small savers' investments into diversified securities. Mutual fund assets increased significantly from Rs. 66,272 crore in 1993-94 to Rs. 99,248 crore in 2005 and Rs. 4,13,365 crore in 2008. Investments by mutual funds in the secondary market also impact stock exchange share prices.

The Securities and Exchange Board of India (SEBI) regulates India's securities markets, overseeing all market issues for the Indian government. Established on April 12, 1988, SEBI gained statutory powers on April 12, 1992, through SEBI regulations. Headquartered in Mumbai, SEBI operates regional offices in Kolkata, Chennai, New Delhi, and Ahmedabad.

*SEBI is Governed by Six Individuals:* One appointed by the Central Government, two officials from central services, one RBI member, and two others.

*Role of SEBI in Capital Market Regulation:* SEBI oversees India's capital market, established by the Indian government to monitor the stock market. It provides recommendations to stock exchanges and strives to mitigate trading malpractices. SEBI ensures that securities trading remains free from speculation and insider trading.

*Educating Investors and Training Intermediaries:* SEBI offers comprehensive guidance to investors to enhance their financial management skills effectively. It educates individuals on various investment topics to prevent fraud and informs investors about all transaction-related matters. SEBI periodically trains financial intermediaries to better serve investors, fostering better understanding and trust.

## VI. Reviews of Literature

Nyamwero Bwire's study "Capital Market Development and Economic Growth in India" (2022) explores the close relationship between capital market development and economic growth. The research investigates how a robust capital market and regulatory environment impact economic growth. Additionally, it analyzes venture capital market experts and regulatory frameworks to assess their role in stimulating the capital market for fostering economic growth. The primary aim of this study is to ascertain the influence of capital market development on economic growth.

In a recent study titled "Development of Domestic Capital Markets in Emerging Economies and Its Impact" by Bansal, Sejal, and Rastogi (2020), the report advocates for leveraging innovative capital market mechanisms to bolster India's social and economic progress. The study begins by contextualizing the relationship between capital markets and GDP growth, comparing capital markets in developed and emerging economies. The subsequent section focuses on the Indian capital market, conducting comparisons with markets in Africa, Indonesia, and other regions. It also examines strategic outcomes to determine the next steps for government and regulatory bodies such as RBI, SEBI, and international financial institutions.

## VII. Objectives of the Study

- Promoting Fairness in Indian Capital Markets.
- Building Inclusive Capital Markets: Lessons from India.
- To assess the impact of COVID-19 on the Indian Stock Market.
- Navigating the COVID-19 Crisis: Indian Stock Market Perspectives.

## VIII. Research Method Used

### *A. Source of Data*

The review relies solely on secondary data sources, including information gathered from the internet, books, annual reports, presentations, and articles.

### *B. Tools and Techniques*

Key tools for data analysis include summary statistics, bar graphs, and tables. Essential Capital Market Development:

Insights from India. Capital markets play a pivotal role in economic development by providing funds for long-term growth. Therefore, robust capital markets are essential for achieving macroeconomic policy objectives such as financial stability and effective economic policy transmission.

In 2018-19, the Bank for International Settlements (BIS) Committee on Global Financial System (CGFS) established a Working Group to study global capital market development trends. The group aimed to identify legal, institutional, structural, and speculative factors that promote robust capital markets, while also examining the role of policy, including prudential measures. Co-chaired by the People's Bank of China and the Reserve Bank of India, the Working Group focused on the growth of both bond and equity markets. These concerns were of interest to developed economies as well, but they are particularly relevant for emerging market economies.

According to the CGFS analysis, drivers of capital market development can be categorized into two groups: drivers that facilitate economic development and drivers specific to the capital market itself.

## IX. Data Analysis and Interpretation

The government securities market has expanded due to a straightforward and market-based primary issuance process for both central and state government securities (G-Secs). G-Secs are issued based on semi-annual pre-announced schedules that specify quantity, maturity, and issuance details. G-Secs have tenors of up to 40 years. While G-Secs include inflation-indexed, capital-indexed, floating-rate, and callable securities, the majority are fixed-coupon securities. All issuances are auctioned weekly, with Primary Dealers (PDs) fully underwriting issues. Market-clearing prices are determined through competition among all participants, including Domestic Institutional Investors (DIIs), Foreign Portfolio Investors (FPIs), and Non-Resident Indians (NRIs), while non-competitive bids provide retail investors with allocated securities at the auction-determined price. Reissuing existing securities accounts for nearly 90% of issuances, enhancing market liquidity by distributing ownership across numerous investors. Since around 2006, the Reserve Bank has introduced a "when issued" G-Sec segment.

Table I: Issuance Profile of Government Borrowings

| Year | Central Government Securities | | State Government Securities | |
|---|---|---|---|---|
| | Gross Issuance | Outstanding Stock | Gross Issuance | Outstanding Stock |
| 2013-14 | 90 | 609 | 31 | 174 |
| 2014-15 | 91 | 648 | 36 | 199 |
| 2015-16 | 85 | 674 | 41 | 243 |
| 2016-17 | 80 | 754 | 56 | 321 |
| 2017-18 | 91 | 795 | 63 | 346 |
| 2018-19 | 83 | 837 | 70 | 404 |

Source: Database of Indian Economy (DBIE), Reserve Bank of India.

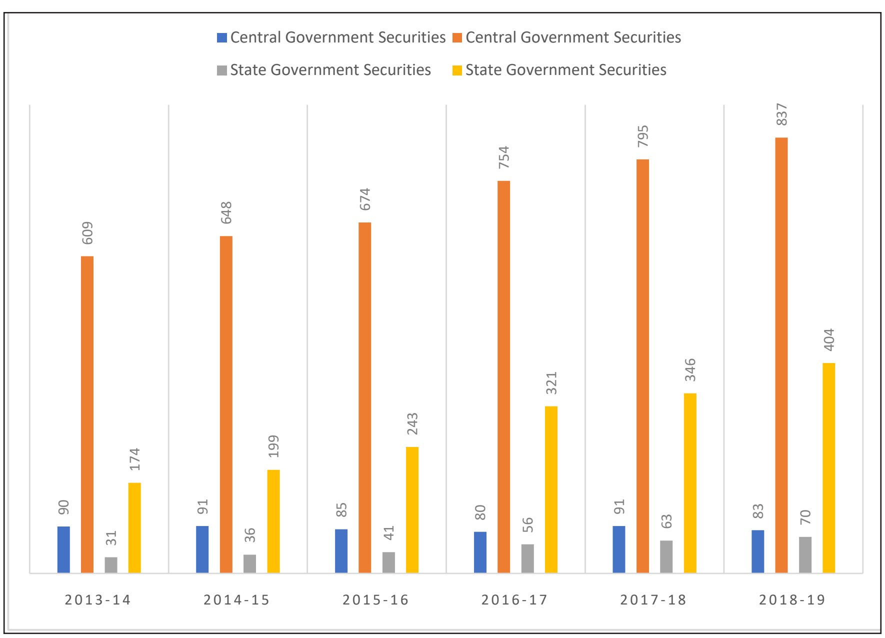


Fig. 1: Issuance Profile of Government Borrowings

TABLE II: CHARACTERISTICS OF CENTRAL GOVERNMENT BORROWINGS

| Year | Issued during the Year | | Outstanding Stock | |
|---|---|---|---|---|
| | Weighted Average Yield (%) | Weighted Average Maturity (Years) | Weighted Average Coupon (%) | Weighted Average Maturity (Years) |
| 2013-14 | 8.4 | 14.2 | 8 | 10 |
| 2014-15 | 8.5 | 14.7 | 8.1 | 10.2 |
| 2015-16 | 7.9 | 16 | 8.1 | 10.5 |
| 2016-17 | 7.2 | 14.8 | 8 | 10.7 |
| 2017-18 | 7 | 15 | 8 | 10.7 |
| 2018-19 | 7.8 | 14.7 | 7.8 | 10.4 |

Source: Annual report of Reserve Bank of India (2017-18) and Database of Indian Economy (DBIE), Reserve Bank of India.

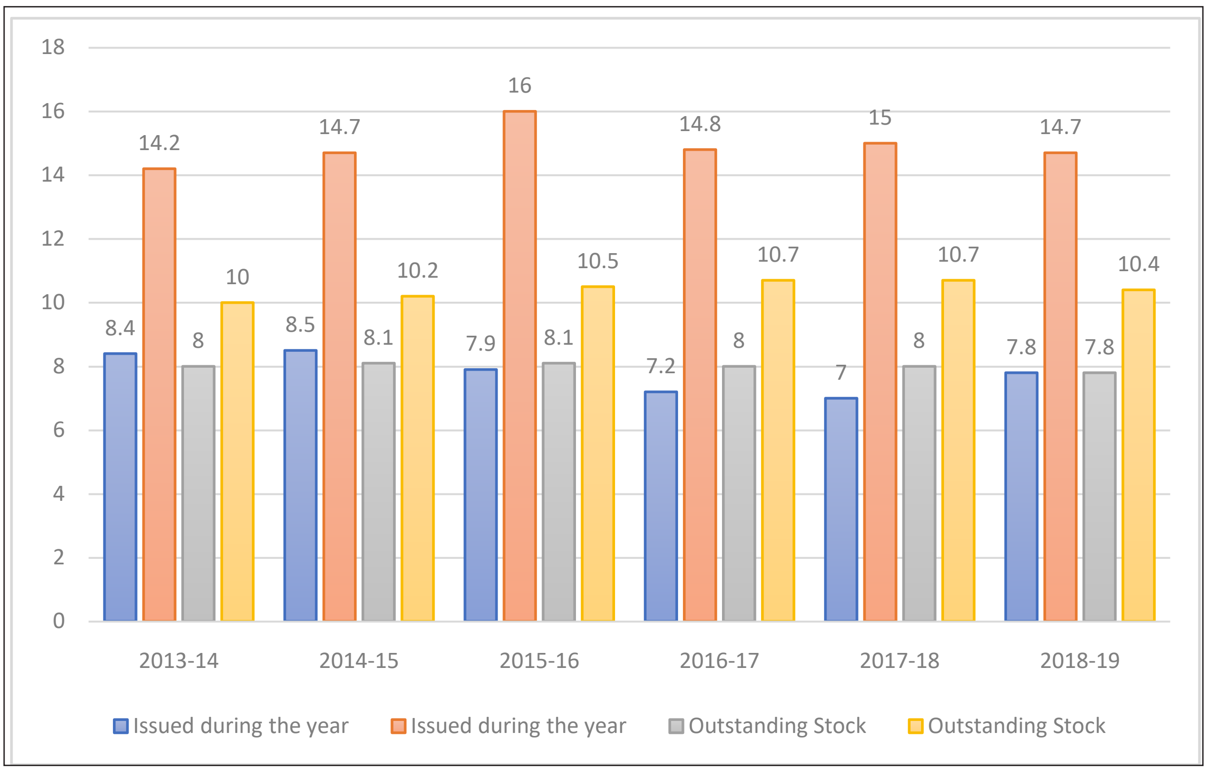


Fig. 2: Characteristics of Central Government Borrowings

## *A. The Indian Stock Market Amid the COVID-19 Pandemic*

The rapid spread of the COVID-19 pandemic has dramatically reshaped the global landscape. Originating from the SARS-CoV-2 virus in December 2019 in Wuhan, Hubei province, China, the pandemic has become a worldwide health crisis and economic downturn. Many countries implemented strict quarantine measures, leading to widespread economic shutdowns to combat the virus. Restrictions on movement between countries have hindered global economic activity, while consumer and business uncertainty has disrupted purchasing patterns and caused market volatility.

The COVID-19 pandemic has significantly impacted both advanced and emerging economies, including the US, Spain, Italy, Brazil, and India, where financial markets have experienced both positive and negative shifts. The outbreak has caused substantial economic disruption, affecting stock and bond markets. Additionally, the pandemic led to plummeting oil prices and rising gold prices. Global economic market volatility has increased significantly due to pandemic-induced fear and uncertainty (Zhang *et al.,* 2020), resulting in substantial losses for investors, including those in India.

The Indian government's nationwide lockdown was one of the world's most extensive measures to control the pandemic's spread.

The COVID-19 epidemic caused a global economic downturn, plummeting oil prices, and rising unemployment in nearly all countries. India, too, felt the economic impact of COVID-19 on its development, economy, and stock market. India's resilient stock market has shown sensitivity to global events. The first case was reported in India on January 30, and a nationwide lockdown was imposed on March 24, 2020, nearly 53 days later.

What if the government had imposed the lockdown earlier? It could have potentially slowed the virus's spread among the population. How did the stock market react to the nationwide lockdown? This case study employs the efficient market hypothesis to analyze how COVID-19 affected the stock market (Fama, 1970), often referred to as event studies (Fama, 1991). This study examines how quickly stock prices responded to alerts about the COVID-19 lockdown.

Table III: A Comparison of Pre- and Post-COVID View of Indian Stock Market

| Index | Indexes (14-01-2020) | Indexes (23-03-2020) | Indexes (24-04-2020) |
|---|---|---|---|
| NIFTY-50 | 12,362 | 7,610 | 9,154 |
| SENSEX | 41,925 | 25,981 | 31,327 |

The table provided illustrates the performance of different sectors before and after the onset of the Coronavirus pandemic. This table highlights the changes in sector-specific returns, offering a comparative analysis of the financial impact the pandemic has had across various industries. By examining the pre- and post-Coronavirus-sectorial returns, one can observe how the pandemic has influenced market dynamics, shifting the profitability and performance metrics within distinct sectors. This comparison serves as a valuable tool for understanding the economic repercussions of the Coronavirus outbreak on a sector-by-sector basis, shedding light on which industries have been most resilient or adversely affected.

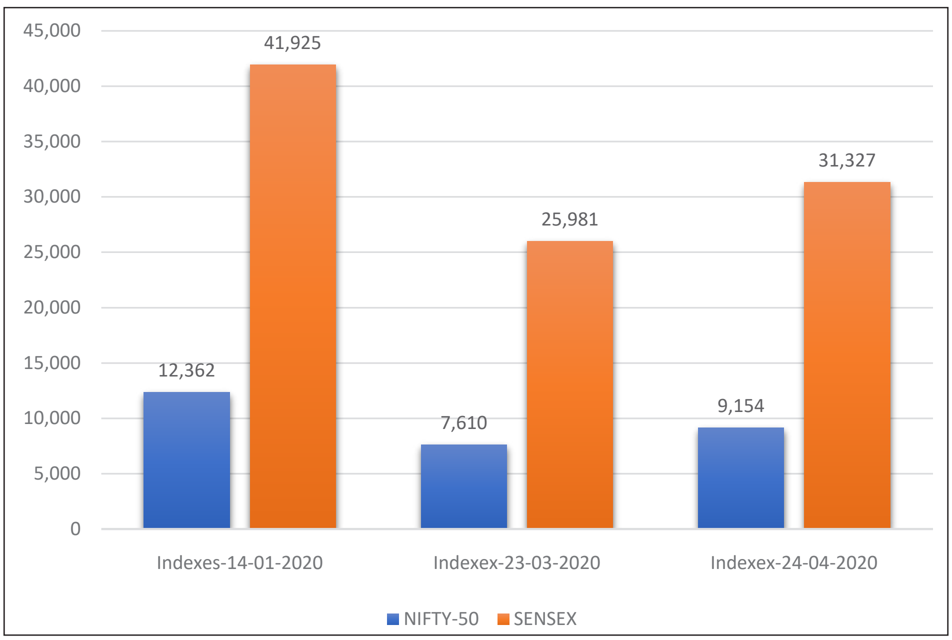


Fig. 3: A Comparison of Pre- and Post-COVID View of Indian Stock Market

Table IV: Pre-COVID-Sectorial Indices Return

| Months | Pre-COVID-Sectorial Indices Return | | | | | | | | Average |
|---|---|---|---|---|---|---|---|---|---|
| | Auto | Finance | Pharma | IT | Bank | FMCG | Metal | Reality | |
| Jan-20 | -0.086 | -0.072 | 0.0529 | 0.1345 | -0.183 | 0.0934 | -0.376 | 0.4493 | 0.0015 |
| Dec-19 | 0.0946 | 0.1154 | -0.0879 | 0.2034 | 0.032 | -0.133 | 0.309 | 0.2707 | 0.1005 |
| Nov-19 | -0.219 | 0.2498 | 0.19% | -0.183 | 0.3032 | -0.212 | 0.243 | 0.2369 | 0.0764 |
| Oct-19 | 0.6006 | 0.1881 | 0.2142 | 0.0662 | 0.1628 | 0.1868 | 0.123 | 0.1942 | 0.2095 |
| Sep-19 | 0.3513 | 0.248 | -0.2655 | -0.156 | 0.312 | 0.3273 | 0.334 | -0.169 | 0.1226 |
| Aug-19 | 0.1137 | -0.115 | 0.0526 | 0.1234 | -0.257 | 0.0328 | -0.612 | -0.004 | -0.0833 |
| Jul-19 | -0.72 | -0.281 | -0.0421- | -0.087 | -0.323 | -0.072 | -0.613 | -0.273 | -0.3015 |

| Months | Pre-COVID-Sectorial Indices Return | | | | | | | | Average |
|---|---|---|---|---|---|---|---|---|---|
| | Auto | Finance | Pharma | IT | Bank | FMCG | Metal | Reality | |
| Jun-19 | -0.161 | 0.0298 | -0.2485 | -0.073 | -0.045 | -0.053 | 0.143 | 0.0157 | -0.0494 |
| May-19 | -0.096 | 0.3229 | -0.4828 | -0.105 | 0.2395 | -0.073 | -0.287 | 0.4303 | -0.0121 |
| Apr-19 | -0.042 | 0.0247 | 0.016 | 0.2953 | -0.103 | 0.0264 | -0.024 | -0.188 | 0.0006 |
| Average | -0.016 | 0.071 | -0.0597 | 0.0111 | 0.013 | 0.012 | -0.076 | 0.0962 | 0.0065 |

Source: NSE India Sectorial Indices.

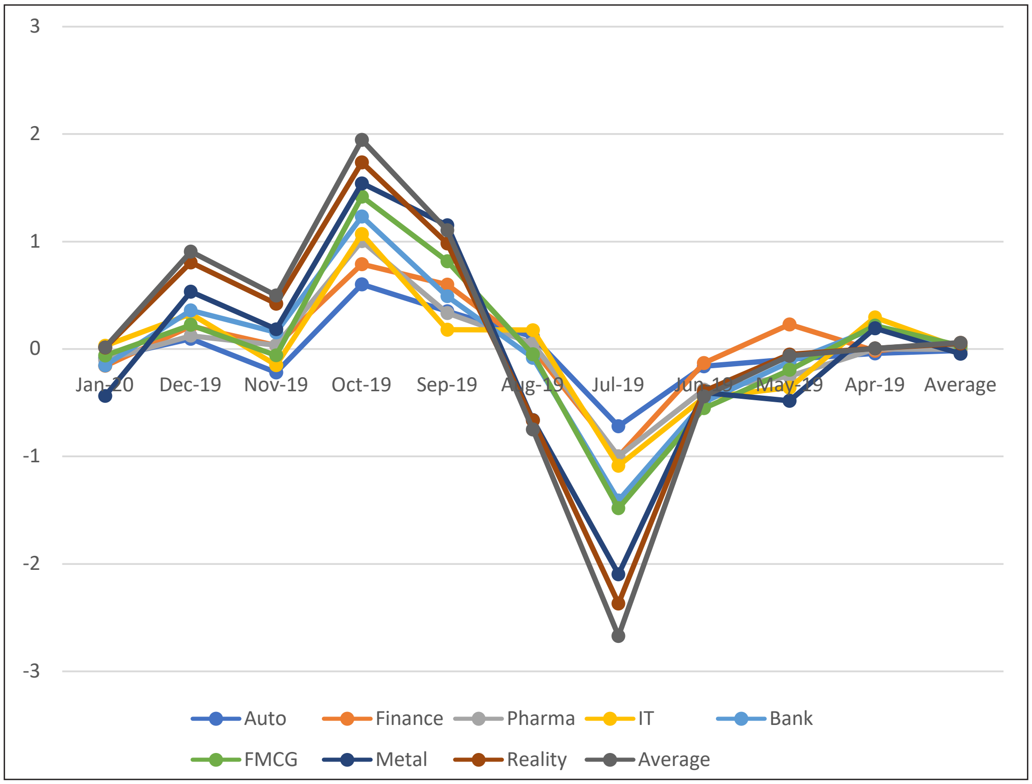


Fig. 4: Pre-COVID-Sectorial Indices Return

Table V: Post-COVID-Sectorial Indices Return

| Months | Post-COVID-Sectorial Indices Return | | | | | | | | Average |
|---|---|---|---|---|---|---|---|---|---|
| | Auto | Finance | Pharma | IT | Bank | FMCG | Metal | Reality | |
| Nov-20 | 1.1311 | 1.6725 | 1.6725 | 1.4257 | 1.8316 | 0.7369 | 1.4511 | 1.5374 | 1.4324 |
| Oct-20 | -0.091 | 1.6118 | 1.6118 | 1.4538 | 1.8135 | 0.6535 | 1.5659 | 1.9314 | 1.3189 |
| Sep-20 | 0.0391 | 1.3399 | 1.3399 | 1.6526 | 1.6251 | 1.1158 | 2.185 | 2.1492 | 1.4308 |
| Aug-20 | 0.3533 | 1.4133 | 1.4133 | 0.7069 | 1.6683 | 0.7572 | 1.48 | 2.1482 | 1.2428 |
| Jul-20 | 0.3484 | 1.5244 | 1.5244 | 1.581 | 1.7134 | 0.6054 | 1.2943 | 1.353 | 1.243 |
| Jun-20 | 0.3517 | 2.0455 | 2.0455 | 1.3401 | 2.2506 | 0.8737 | 1.8526 | 2.4726 | 1.6544 |
| May-20 | 0.2757 | 3.3899 | 3.3899 | 1.7296 | 3.4643 | 1.57 | 2.6798 | 2.7595 | 2.4073 |
| Apr-20 | 1.2277 | 3.7542 | 3.7542 | 3.1701 | 4.0971 | 2.4957 | 3.3631 | 2.606 | 3.0585 |
| Mar-20 | -1.799 | 5.9253 | 5.9253 | 4.6429 | 5.817 | 4.2042 | 5.3246 | 4.5423 | 4.3228 |
| Feb-20 | -0.696 | 1.3342 | 1.3342 | 1.5334 | 1.1929 | 1.0152 | 2.4954 | 1.6088 | 1.2273 |
| Average | 0.114 | 2.4011 | 2.4011 | 1.9236 | 2.5474 | 1.4028 | 2.3692 | 2.3111 | 1.9338 |

Source: NSE India Sectorial Indices.

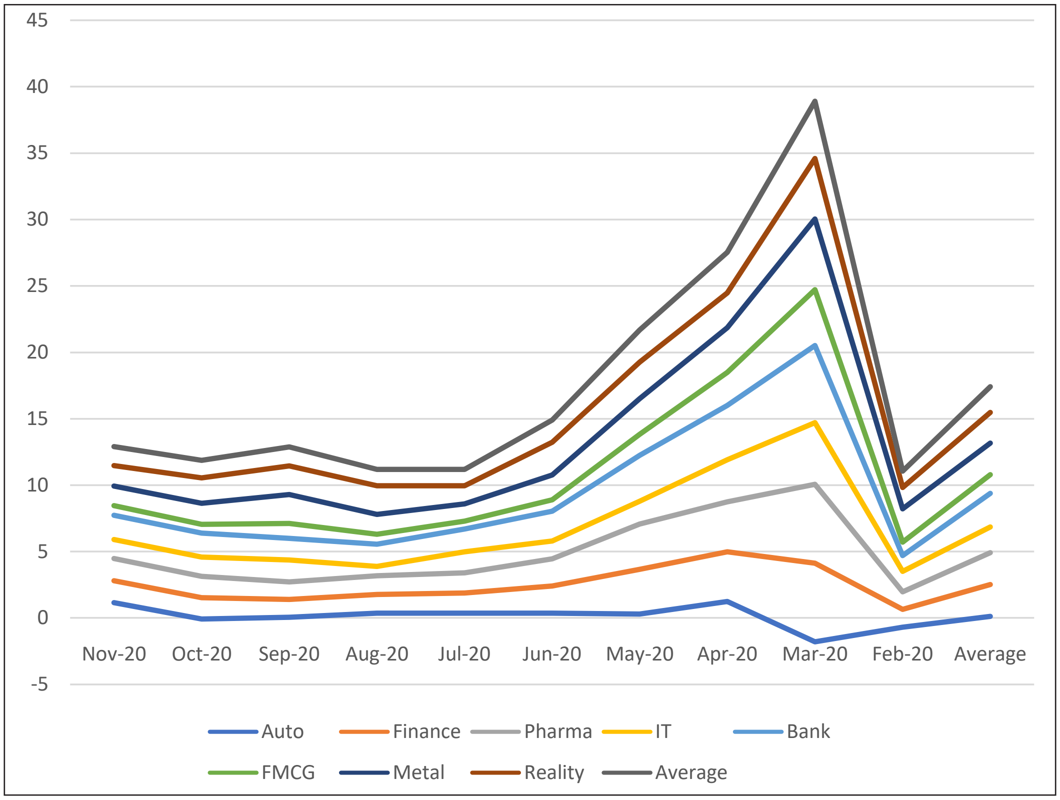


Fig. 5: Post-COVID-Sectorial Indices Return

The two tables above present sectorial record returns before and after the Coronavirus pandemic. We reviewed eight specific areas, calculating midpoints for each month and area. The month-wise analysis indicates that October had the highest return pre-Coronavirus, with a value of 0.2095, while April 2020 achieved the highest return post-Coronavirus, with a value of 0.7638.

The table evaluates the hypothesis regarding pre-and post-Coronavirus sectorial lists. The results consistently support the hypothesis across all industries, indicating that sectoral lists exhibit similar returns before and after the Coronavirus outbreak. The acceptance/rejection criteria are based on the P two-tail value being less than the critical value. The critical return value for all sectors is below 2.262, leading to the acceptance of the null hypothesis.

## X. Conclusion

Over recent decades, the Indian capital markets have emerged as some of the world's most promising. Due to financial development, priorities have shifted significantly. Online, screen-based trading and dematerialization have replaced open outcry and physical share delivery. The emergence of the NSE as a major stock exchange and SEBI as a robust regulator are key milestones in the more than 150-year history of Indian capital markets. In the last twenty years, these markets have undergone significant transformation, but they also face inherent issues such as insider trading, inadequate liquidity, and speculation. Additionally, new challenges have arisen due to advancements in technology. Activities by foreign institutional investors (FIIs) and the derivatives market are influencing Indian capital markets. While SEBI has managed the markets effectively, there is a need for further expansion. Investor education remains a crucial strategy for the growth of the capital market.

SEBI and several stock exchanges are addressing these issues, but much work remains. Enhancing investor education could increase capital market penetration in semi-urban and rural areas. Additionally, modest and genuine investors need targeted confidence-building measures. A five-year vision plan for the next 30 years is crucial for the development of the capital market. As markets become more integrated with global markets, a prudent approach is necessary to attract smarter foreign investment into Indian capital markets. With India remaining an appealing investment destination for international market players, there is a need for stronger domestic asset houses and effective regulations to support a cautious yet optimistic approach towards capital account convertibility.

Since 1980, India's capital market has grown significantly, with a notable surge by the end of the decade. This growth is remarkable compared to other emerging market economies.

Factors such as increased nominal interest rates since the early 1990s, incentives on traded securities, and related regulations and procedures likely contribute to this expansion.

The development of the capital market has redirected domestic financial savings from bank deposits to shares and debentures without increasing overall saving rates or the proportion of financial assets. The dominance of debt securities has reduced the role of equity capital in capital market mobilization, although the amount of new equity capital raised has multiplied. Promoters have significantly increased their contributions, potentially enhancing financial performance as they now hold a larger stake in their companies.

The entire analysis demonstrates that the Indian capital market is experiencing significant growth. The following points can be concluded:

- The Indian capital market began trading East India Company securities in the 18th century.
- It has been a cornerstone of the economy since the 1890s.
- The capital market plays a crucial role in wealth distribution and economic development in India by converting savings into investments.
- Significant changes have occurred in the capital market since the New Economic Policy of 1991.
- The Indian government and SEBI have implemented reforms to boost stock performance.
- Analysis indicates that the Indian capital market is experiencing substantial growth.
- The study concludes that Indian capital markets have achieved long-term sustainability, yet their potential for further growth and development is boundless.
- The report also highlights the impact of the Coronavirus pandemic on Indian stocks.

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