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Capital Market Reforms in India: A New Era of Transparency and Efficiency

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Abstract
Capital markets play a vital role in economic development by facilitating capital formation, offering investment opportunities, and ensuring efficient resource allocation. Over the years, significant reforms have been implemented to enhance transparency, investor protection, and market efficiency. The establishment of the Securities and Exchange Board of India (SEBI) has played a transformative role in reshaping the Indian financial system. These reforms have led to greater transparency, easier access to international markets, and improved investor protection by restructuring stock exchanges and introducing robust surveillance and monitoring systems. Additionally, the establishment and technological advancements in stock exchanges such as the National Stock Exchange (NSE) and the Over-the-Counter Exchange of India (OTCEI) have revolutionized trading mechanisms, making markets more accessible and efficient. The NSE, with its fully automated screen-based trading system, has significantly enhanced market integrity, while OTCEI has provided a platform for small and medium enterprises to access capital efficiently. This paper explores the major reforms in capital markets .

Introduction

Capital market is crucial for mobilizing medium term and long term funds. It refers to all facilities and the institutional arrangements for borrowing and lending term funds (medium term and long term). An efficient, competitive and diversified financial system is very much essential to raise the efficiency of available savings, increase the return on investment and thus to promote the accelerated growth of the economy as a whole.A financial system or financial sector functions as an intermediary and facilitates the flow of funds from the areas of surplus to the areas of deficit. Economic development of any economy, upto a great extent, is dependent upon the effective functioning of efficient financial markets. Whereas satiability of financial markets in an economy is dependent upon efficient working of capital market. Capital market has a crucial significance to capital formation. For a speedy economic development adequate capital formation is necessary. Capital markets serve as a backbone of the financial system, enabling businesses and governments to raise funds.The depleting foreign currency reserves in 1991 forced India to start the process of economic liberalisation. The reforms were accomplished through globalisation ,liberalisation and privatisation Other factors which forced Indian Government to initiate reforms in capital markets were the technological advancements, and economic crises. Capital market reforms refer to regulatory changes and policy initiatives aimed at enhancing the efficiency, transparency, and accessibility of financial markets for investors. These reforms often target stock exchanges, bond markets, derivatives markets, and other financial instruments. The key objectives of reforms included attracting foreign investment, deepening the market by broadening investor participation, improving market infrastructure, enhancing transparency and corporate governance, and fostering innovation in financial products. Moreover, capital market reforms play a crucial role in supporting economic growth by channeling savings into productive investments, facilitating corporate fundraising, and enabling efficient allocation of capital. The reforms encourage entrepreneurship and innovation by providing access to diverse sources of

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financing. Additionally, the development of robust capital markets reduce reliance on traditional bank financing, fostering a more resilient financial system capable of fueling long-term economic expansion.These reforms have strengthened investor confidence by instilling trust in the fairness and efficiency of markets. Measures such as stricter regulatory oversight, improved transparency through disclosure requirements, and investor protection mechanisms have contributed to a more secure investing environment. Additionally, the liberalization of markets has often attracted both domestic and foreign investors, expanding investment opportunities and liquidity.

The period since 1991 has witnessed significant reforms in the Indian capital market, aimed at promoting transparency, efficiency, and investor protection. Some key measures and reforms include:

Key Reforms in Capital Markets

Establishment of Securities and Exchange Board of India (SEBI):

SEBI (Securities and Exchange Board of India) was established in 1988 as a non-statutory body and was granted statutory status through an Act of Parliament in 1992. The SEBI was established with the primary goal of protecting the interests of investors in the securities market ,to regulate the activities of merchant banks, to control the operations of mutual funds, to act as a promoter of stock exchange activities, and to act as a regulatory authority of new issue activities of various companies. SEBI has enforced stringent norms on initial public offerings (IPOs) to safeguard investor interests.

SEBI also assumed the responsibility of monitoring the markets and stock exchanges. The biggest initiative towards that was the launch of the Integrated Market Surveillance System (IMSS) in 2006. The IMSS's primary objective is to monitor the market activities across various stock exchanges and market segments including both equities and derivatives. IMSS collects and analyses data not only from the stock exchanges but also from NSDL, CDSL and clearing corporations.

SEBI has introduced various guidelines for capital issues in the primary market. They are explained below

- Companies are required to disclose all material facts and specific risk factors associated with their projects
- SEBI has also introduced a code of advertisement for public issues for ensuring fair and truthful disclosures
- SEBI has allowed the companies to determine the par value of shares issued by them.
- SEBI has allowed issues of IPOs through "book building" process.

Repealing of The Capital Issues (Control) Act, 1947 : The Capital Issues (Control) Act, 1947 was repealed in May 1992, allowing issuers of securities to raise capital from the market without requiring the consent of any authority either for floating an issue or pricing it. However, the issuers are required to meet the SEBI guidelines for disclosure and investor protection, which are being strengthened from time to time to protect investor interest.

FIIs Permitted to Operate in the Indian Market: One of the significant steps towards integrating the Indian capital market with the international capital markets was the permission given to foreign institutional investors to operate in the Indian market. Foreign institutional investors such as mutual funds and pension funds were allowed to invest in equity shares as well as in debt market, including dated government securities and treasury bills.

Permission to Access Global Funds Market: Indian companies are allowed to access global finance market and benefit from the lower cost of funds. They have been permitted to raise resources through issue of American Depository Receipts (ADRs), Global Depository Receipts (GDRs), Foreign Currency Convertible Bonds (FCCBs) and External Commercial Borrowings (ECBs). Also, Indian companies can list their securities on foreign stock exchanges through ADR/GDR issues

Intermediaries under the Purview of SEBI: Merchant bankers, and other intermediaries such as mutual funds including UTI, portfolio managers, registrars to an issue, share transfer agents, underwriters, debenture trustees, bankers to an issue, custodian of securities, and venture capital funds – have been brought under the purview of SEBI

Credit Rating Agencies: Various credit rating agencies such as Credit Rating Information Services of India Ltd. (CRISIL – 1988), Investment Information and Credit Rating Agency of India Ltd. (ICRA – 1991), Cost Analysis and Research Ltd. (CARE – 1993) and so on were set up to meet the emerging needs of capital market. These agencies assess the financial health of different financial institutions and agencies related to the stock market activities. It is a guide for the investors also in evaluating the risk of their investments.

Introduction of Electronic Trade: The adoption of electronic trading platforms facilitated faster and more efficient transactions in the stock market . Setting up of National Stock Exchange (NSE) in November 1992is a landmark in Indian capital markets. Instead of trading memberships being confined to a group of brokers, NSE ensured that anyone who was qualified, experienced, and met the minimum financial requirements was allowed to trade NSE which became operational in June 1994 was the first exchange in India to introduce an electronic trading facility has developed into a sophisticated , electronic market. Using electronic trading systems , NSE was the first exchange in the world to use satellite communication technology for trading, using a client server based system called National Exchange for Automated Trading (NEAT), which operates on a strict price/time priority. This system enabled efficient trade and the ease with which trade was done.NSE provides investors with a fair, efficient, and transparent securities market.

Over the Counter Exchange of India (OTCEI) was set in 1990 to provide investors and companies with an additional way to trade and issue securities. OTCEI provided a much needed second tier segment of the Indian securities market to companies and investors The purpose of the OTCEI is for smaller companies to raise capital, which they cannot do at the national exchanges due to their inability to meet the exchange requirements.The OTCEI has rules that are not as rigid as the national exchanges, allowing small companies to gain access to the capital they need to grow. The objective is that once they grow to a certain level and are able to meet the requirements to be listed on the national stock exchanges, they will make the switch over and leave the OTCEI behind.

Disclosure and Investor Protection (DIP) Guidelines for New Issues: In order to remove inadequacies and systematic deficiencies, to protect the interests of investors and for the orderly growth and development of the securities market, the SEBI has put in place DIP guidelines to govern the new issue activities.Companies issuing capital in the primary market are now required to disclose all material facts and specify risk factors with their projects.

Depository System: A major reform in the Indian Stock Market has been the introduction of depository system and scrip less trading mechanism in 1996.Before this, the trading system was based on physical transfer of securities.

A depository is an organization which holds the securities of shareholders in electronic form, transfers securities between account holders, facilitates transfer of ownership without handling securities and facilitates their safekeeping.Transfer of ownership of securities is done through simple account transfers. This method does away with all the risks and hassles normally associated with paperwork and is much more cost effective as compared to physical transfer.

The first depository in India NSDL was established in November 1996 to ensure the safety and soundness of Indian capital market by developing settlement solutions that increase efficiency, minimise risk and reduce costs.

Another depository CDSL CDSL commenced its operations in July 1999. CDSL was set up with the objective of providing convenient, dependable and secure depository services at affordable cost to all market participants .

The National Securities Clearing Corporation Ltd. (NSCCL): The NSCL was set up in 1996. It has started guaranteeing all trades in NSE since July 1996. The NSCL is responsible for post-trade activities of the NSE. It has put in place a comprehensive risk management system, which is constantly monitored and upgraded to pre-expect market failures.

The Clearing Corporation Of India Limited: The Clearing Corporation of India Ltd. (CCIL) was set up in 2001 to provide an institutional infrastructure for the clearing and settlement of transactions in Government Securities, Money Market instruments, Foreign Exchange and other related products. The objective was to bring efficiency to the transaction settlement process and mitigate the systemic risk emanating from settlement related problems and counterparty risk.

Establishment of Investors Education and Protection Fund (IEPF) : The Investors Education and Protection Fund (IEPF) was set up in 2001. It works in educating and guiding investors. It tries to protect the interest of the small investors from frauds and malpractices in the capital market. The IEPF will be utilized for the promotion of awareness amongst investors and protection of their interest.

Trading in Central Government Securities

- In order to encourage wider participation of all classes of investors, including retail investors, across the country, trading in government securities has been introduced from January 2003.
- Trading in government securities can be carried out through a nationwide, anonymous, order-driver, screen-based trading system of stock exchanges in the same way in which trading takes place in equities

Mutual Funds: Emergence of diversified mutual funds is one of the most important development of Indian capital market.

- Their main function is to mobilize the savings of general public and invest them in stock market securities.
- Mutual funds are an important avenue through which households participate in the securities market.
- As an investment intermediary, mutual funds offer a variety of services / advantages to small investors. SEBI has the authority to lay down guidelines and supervise and regulate the working of mutual funds.

Growth of Derivative: Since June 2000, the NSE has introduced the derivatives trading in the equities. In November 2001, it also introduced the future and options transactions. These innovative products have given variety for the investment leading to the expansion of the capital market.

Insurance Sector Reforms: Indian Insurance sector has also witnessed massive reforms in the last few years. The Insurance regulatory and development Authority (IRDA) was setup in 2000. It paved the entry of the private insurance firms in India. As many insurance companies invest their money in the capital market, it has expanded.

Commodity Trading: Along with the trading of ordinary securities, the trading in commodities is also recently encouraged. The Multi Commodity Exchange (MCX), country's first exchange dedicated to commodity derivatives was setup in 2003. The volume of such transactions is growing at a splendid rate.

IPO Grading:- SEBI has made it compulsory for companies coming out with IPOs of equity shares to get their IPOs graded by at least one credit rating agency registered with SEBI from May 1, 2007. This measure is intended to provide the investor with an informed and objective opinion expressed by a professional rating agency after analyzing factors like business and financial prospects, management quality and corporate governance practices etc.

Currency Derivatives: **-** Currency futures is a transferable futures contract that specifies the price at which a currency can be bought or sold at a future date. Currency future contracts allow investors to hedge against foreign exchange risk. It is introduced in India in 2008.

Settlement Guarantee Funds: Settlement guarantee funds were established at all stock exchanges to enhance the security and reliability of settlement processes.

Compulsory Dematerialization: To eliminate issues associated with paper trading and accelerate the transfer process, the compulsory dematerialization of share certificates was introduced.

Demutualization in Stock Exchanges: Demutualization is a process in which the ownership and management of a stock exchange, traditionally held by its member-brokers, are separated. This involves the divestment of ownership from the brokers, and shares of the exchange are sold to external investors. The primary aim of demutualization is to eliminate the inherent conflict of interest that arises when brokers, who are also owners, are involved in the management of the exchange.

Other Reforms:

- It is mandatory for listed companies to announce **quarterly results**. This enables investors to keep a close track of the scrips in their portfolios. The declaration of quarterly results is in line with the practice prevailing in the stock market in developed countries.
- To check price manipulation, **mandatory client code and minimum floating stock** for continuous listing were stipulated in November 2001.
  The government amended the **Securities Contracts (Regulation) Rules, 1957** to standardize listing requirements at stock exchanges.
- Clause 49 of the listing agreement was introduced to enhance corporate governance practices. It mandates that listed companies have at least half of their directors on the board as independent directors.
- The introduction of anchor investors in Initial Public Offerings (IPOs) ensures a smooth listing process and prevents price manipulation. Anchor investors are allotted a substantial number of shares and commit to not selling them immediately after listing.
- Stringent regulations were introduced for participatory notes to enhance transparency and curb potential misuse.
- The regulatory framework for credit rating agencies was strengthened, ensuring greater accountability and reliability in credit assessments.

These reforms reflect the commitment of regulatory authorities to create a robust and investor-friendly capital market in India. The measures have played a crucial role in fostering investor confidence, market integrity, and the overall development of the securities market.

Conclusion

Capital market is playing its important role in the development of Indian economy. Indian capital market suffered bruises in the last part of the nineties owing to the manipulative trade practices of unscrupulous brokers and other participants. The problems experienced in the Indian capital markets as well as the scams were significant as they proved to be hindrances in the smooth functioning of capital markets. Due to these hindrances a genuine investor has remained aloof from the market while more and more speculators and institutional investors continued to dominate the capital markets in India. But due to the reforms in the capital markets, it has been witnessing fine times in the recent past.SEBI has done a commendable in terms of stringent regulations. Capital market reforms are integral to fostering a robust financial ecosystem. The penalties must be more severe to deter the market players from indulging in malpractices. While substantial progress has been made, continuous efforts are required to adapt to emerging trends and challenges. A well-regulated and technologically advanced capital market is crucial for sustained economic growth and financial stability.

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