CHAPTER 2
LITERATURE REVIEW
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2.1 Introduction

In general, a literature review is a means to explain and analyze investigation that has been conducted and studies that have been published on the research topic. Therefore, we can say that literature review is an analysis of existing research; it also helps in explaining and justifying how the researcher’s investigation will answer the questions or gaps in its area of research. “Literature review relates to a study to the larger, ongoing dialogue in the literature, filling in gaps extending prior studies” (Cooper, 1988; Marshall and Rossman, 2006). In other words we can say that literature review provides a framework for conducting the research and helps in understanding more clearly the importance of study. It also helps in comparing the results with other findings in a better way. Cooper (1988) “also suggests that literature review can be integrative in nature under which the researcher summarizes broad themes in the literature”. Hence in this chapter, researcher has thrown some light on the literature review related to the studies of Capital Market, Stock Market and Stock Exchange.

2.2 Trend of Indian Capital Market

Capital market in India was introduced during eighteenth century when securities of East India Company were traded in the country. The trading pattern of securities was unorganized and there were only two trading centers in the country, one was in Bombay (presently known as Mumbai) and the other was in Calcutta (presently known as Kolkata). But the actual phase of capital market in India was started in the year 1875, when brokers formed the stock exchange and started trading under the banyan tree. Due to the British rule in India, capital
market was not able to grow to its fullest and the reason behind it was that British
government was not at all interested in the economic growth of the country.

“Then during 1957, BSE (Bombay Stock Exchange) became the first exchange to be
recognized by the Indian government under Securities Contracts Regulation Act. But still the
size of Capital Market remained small during first and second Five year Plans as the major
focus of the government was on the Agriculture sector undertakings and Public sector
undertakings. During this period, public sector undertakings (PSU’s) were much stronger in
terms of paid up capital than private sector undertakings but the disadvantage with them was
that they were not listed on the stock exchanges. Beside this, Controller of Capital Issue made
some strict regulations for new issues due to which majority of the companies were de-
demotivated from going public and this continued for almost four and a half decades.”

Then during July 1974, capital market received a ruthless hold up by the government.
Government of India announced Dividend Restriction Ordinance in the country i.e. “payment
of dividend by companies was restricted to 12% of the face value or one-third of the profit of
the companies whichever is lower can be distributed as computed under section 369 of
Companies Act.” Then in the year 1977, Dirubhai Ambani tapped the capital market and still
he is the one who dominates trading at all stock exchanges in India.

2.3 Evolution of National Stock Exchange in India

During 1992, National Stock Exchange (NSE) was established in India as the first
demutualized electronic exchange. National Stock Exchange played a vital role in reforming
the Indian securities market. National Stock Exchange was started by a clutch of leading
Indian Financial Institutions with the aim to bring transparency to the Indian capital market.

The domestic investors for NSE were LIC, SBI, IFCI, IDFC Limited and Stock Holding Corporation of India. National Stock Exchange is the first exchange in to introduce electronic trading facility. Initially in the year 1992 exchange was incorporated as a tax paying company but later in the year 1993 it was recognized as stock exchange under Securities Contracts Regulation Act, 1956. Then later in the year June 1994, NSE commenced operations in Wholesale Debt Market segment and simultaneously in November 1994, Capital market segment was commenced by NSE. Lastly, operations in Derivative segment were started in the year June 2000. Currently NSE has a market capitalization of more than US$ 1.65 trillion. The main objective with which NSE was set-up were to establish a nation-wide trading facility for equities, debt instruments and hybrids, to provide a proper communication network between investors, to offer fair, transparent and efficient security market to their investors by using electronic trading system and therefore, to meet the international standards of securities market.

“In India, before the formation of National Stock Exchange, the director of stock exchange was elected by member brokers and by the government. Generally in the board there were member brokers, whereas the executive director was the operational chief of the stock exchanges. Their duty was to ensure that the day-to-day operations of stock exchange were carried out according to the rules and regulations that governed its functioning. But during that period, brokers generally governed the stock exchanges themselves and they operated more for their own benefit rather than that for the investors. There were many instances when manipulation was seen in the stock market and then NSE was established as an ‘avtar’ in the list of stock exchanges which came with the concept of demutualization of stock exchange. This means NSE ensured that its management and brokers were separated or ‘de-mutualized’
so that no broker member could become an office bearer of the stock exchange and this concept changed the face of stock exchanges in India.”

2.4 Studies on Stock Market

The transaction which takes place between the two parties is known as trade in stock market. There is a transfer for money of a stock or security from a seller to the buyer. The participants in the stock market varies, it can be small stock investors to large trade investors. These investors can be based anywhere in the world, they may include banks, insurance companies and hedge funds. There are two types of transactions being carried out. First is open outcry which means, where transactions are carried out on a trading floor and traders enter into oral bids and offers simultaneously. An example of such kind of exchange is NYSE (New York Stock Exchange). The second type of stock exchange is virtual kind, which is composed of networks of computers where traders are made electronically traded. An example of such exchange is NASDAQ (National Association of Securities Dealers Automated Quotations). Therefore the main purpose of stock exchange is to aid the exchange of securities between buyers and sellers by providing a market place which can be either virtual or real.

Trading is done on the most popular exchanges as it gives the best price and the largest number of potential counter parties i.e. buyers for a seller and sellers for a buyer. To make trading a bit simpler there are brokers as well outside the exchange who bring parties together to trade.

There are number of participants in the market. Market participants consists of institutional investors such as banks, insurance companies, mutual funds etc, individual retail investors
and corporations trading in their own shares. Some studies have been conducted and it was found that individual investors and corporations who are trading in their own shares usually receive higher risk adjusted returns than retail investors.

Previously, buyers and sellers were individual investors but over time market have become more institutionalized. There are large institutions like insurance companies, mutual funds, pension funds, hedge funds, banks and other financial institutions. Due to the formation or rise of the institutional investors there are some improvements in market operations.

2.4.1 Studies on Efficiency and Liquidity of Stock Market

A study was conducted by William (1965) about the stock market efficiency. This research analyzed the processes of price equilibrium of both short run and long run and its impact on stock market efficiency. Along with this he also shed a light on a very crucial aspect that is for better allocation of nation’s capital resource, stock market efficiency can act as an important tool.

Similarly stock market liquidity was researched by Rohatgi (1973) which concludes “that the basic function of stock market is to provide ready marketability or liquidity to holdings of securities. The ideal stock market is one that can provide immediate and unlimited liquidity.”

Cho (1986) argues that “financial market liberalization may remain incomplete without an efficient market for equity capital as a means of spreading risk and reward”.

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**Bancivenga and Smith (1992)** “state that a new stock market also can increase economic growth by reducing holdings of liquid assets and increasing the growth rate of physical capital, at least in the long run. In the short run, however, the equilibrium response of the capital stock to a new stock exchange can be negative because the opening of an exchange can increase households’ wealth and raise their contemporaneous consumption enough to temporarily lower the growth rate of capital.”

**Mohan, et. al (2002)** analyzed “the change in volatility in the Indian stock market. They studied the introduction of future trading using daily closing prices of Nifty and weekly closing prices of Satyam Computers Ltd. The individual stocks seem to be slightly more volatile and their volatility has become less and less dependent on past volatility and more dependent upon the current period. The average long-term volatility has decreased at an index level.”

According to **Ibrahim and Aziz (2003)** “the performance of a stock market can be affected by influence. Influence can be defined as a power to affect persons or events based on prestige thus causing something without any direct or apparent effort.”

A study on “Stock Return Volatility Patterns in India” was conducted by **Batra (2004)**. In his study he analyzed the stock return volatility of two different phases i.e. Pre liberalization and post liberalization period in India. Study was examined for the time period from 1979-2003. Through this study it was found that the stock market was unstable during BOP crisis and phase of economic reforms in India. Further it was examined that the volatility in stock market is affected more by domestic events i.e. economic and political events rather than the international events.
Sah and Narayan (2009) “examined the seasonality of stock market in India. S&P CNX was considered as the representative of stock market in India and tested whether seasonality were present in Nifty and Nifty Junior returns using daily and monthly data sets. The study found that daily and monthly seasonality are present in Nifty and Nifty Junior returns. The analysis of stock market seasonality using daily data, we found Friday Effect in Nifty returns while Nifty Junior returns were statistically significant on Friday, Monday and Wednesday. In case of monthly analysis of returns, the study found that Nifty returns were statistically significant in July, September, December and January. In case of Nifty Junior, June and December months were statistically significant. The results established that the Indian stock market is not efficient and investors can improve their returns by timing their investment”.

One of the prominent studies was conducted by Paramati (2011) ‘An empirical analysis of stock market performance and economic growth: Evidence from India’ which examined the role of economic growth in determining the performance of stock market. In this study, it was investigated that whether stock performance leads to economic growth or economic growth leads to stock market development. Under this study, stock prices of Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) were considered and through their study it was revealed that there is no relationship between BSE and GDP but on the other hand there is a unidirectional relationship between NSE and GDP. Moreover, this study was conducted under two time spans i.e. short-run dynamics and long-run dynamics of stock market.
Nowbutsing (2011) analyzed the relationship between two important constituents of economy with special reference to Mauritius i.e. stock market development and economic growth and hence it was concluded that there is a positive relation between the two.

2.4.2 Investment Patterns in Stock Market

A study was conducted by Gupta (1992) “Stock Trading in India , he examined that there is a need to regulate the volume of speculation, as it is crucial to serve the needs of liquidity and price continuity for proper working of stock exchanges in India. It suggests draft of corporate securities in more than one stock exchange at the same time to improve liquidity. The study also wishes the cost of issues to be low, in order to protect small investors.”

As the investment pattern changed over the time there were studies been conducted on them and one of the research was done by Grewal et. al (1984) who suggested few investment rules for selling the shares in stock market. They suggested the investors that should not buy the unlisted shares as stock exchange does not permit the same. Another suggestion from their findings was that before making a purchase, investor should analyze that they are not buying inactive shares because they are not profitable as well as there are no buyers for the inactive shares. And lastly, they suggested the investors, not to buy shares of closely-held companies because shares of such companies are less active than those of others. Therefore, one should sell these shares as soon as one earns a reasonable reward instead of holding for a longer duration.

Further, Singh (1986) disclosed the basic rules for investors on how to select the company for investment. Her study focused on investment process i.e. before making an investment one
should analyze and measure the return and risk associated with that particular investment. Therefore, before making an investment, investor should carefully analyze the financial statements with special reference to profitability ratio, solvency ratio, EPS and efficiency of the company.

**Gupta (1992)** analyzed “that there is existence of wild speculation in the Indian Stock Market. Researcher opinioned the investors to be aware of short term speculation. Short-term speculation leads to artificial price. An artificial price is one which is not defensible by probable earnings, dividends, financial strength or which is brought by speculators through rumors or manipulations. Therefore, researcher said that artificial prices generally tend to crash the market sometimes. Hence, investor should be cautious while dealing with the shares.”

During this period many other researches were conducted, **Jain (1992)** suggested the investors about buying and selling of shares. Researcher advised the investor to buy the shares of a growing company and to diversify ones investment equally among different growing companies. On the other hand, researcher also suggested about selling of shares. The moment company reaches the peak or is at maximum of its growth stage, investor should sell the shares. Moreover, investor can also sell its shares, the moment he realizes that he had made a mistake in the selection of shares. Therefore, researcher concluded the study by saying, “the only option to decide when to buy and sell high priced shares is to identify the individual merit or demerit of each of the shares in the portfolio and then arrive at a decision.”
Randal (1992) “suggested the investors about how to win on the stock market. Initially, the investor should have a long term vision and a proper plan to reach his/her goals and investor should never be pessimist. Under this study, he advised the investors to be patient as only consistent money in equities can be earned only if one is a patient investor. Finally he concluded his study by saying that “investing in the stock market should be an unemotional endeavor”.

Thunuguntla (2011) has focused his study on “old age philosophy on understanding the companies policies, awareness and sticking to the basics should be given due respect. He examined that buyer should be made aware of the investor that he has to put price tag to his hard earned money and along with that there is a need for investors education, investors awareness and the connections should be on stable income than becoming rich overnight.”

2.4.3 Studies on Equities and Derivatives

Trading in equity is a major activity which takes place in stock market. Securities traded under equity market can be public stocks or privately traded stocks. Generally, equity trading can be performed by owner itself as well as by an agent. If an agent performs the trade on behalf of owner/client, the process is known as agency trading and for performing the trade agents are paid commission. Moreover, there are also market makers who buy and sell a particular company’s shares which help to limit price variation i.e. volatility.

There are various types of equities: Stock on the basis of market capitalization, on the basis of dividend payment, on the basis of fundamentals, on the basis of risk and on the basis of cyclic trends.
Stock on the basis of market capitalization includes “small-cap stocks, Mid-cap stocks and Large-cap stocks”. Small-cap stocks represent small size companies that have market capitalization up to Rs. 250 crores. Investor who wants to generate significant gains in the long run and do not require current dividends, can opt for small-cap stocks. Many of the companies are new in the market and even have the potential to grow rapidly in the near future. Therefore, stocks of such companies are cheaply available and investor can buy them at initial stage to earn profit in the long run. Mid-cap stocks represent medium sized companies that have market capitalization in the range of Rs 250 crores and Rs 4000 crores. Lastly, Large-cap stocks represent largest companies in the market like TATA, RELIANCE, and ICICI. Investors who invest in large-cap stocks have an advantage of receiving higher dividends as compared to the former cap stocks.

Stock on the basis of dividend payment includes income stocks and growth stocks. Income stocks are low risk stocks and they are also called dividend-yield or dog stocks. These are preferred by the investors because they promise regular dividend and even investors are not taxed for their dividend incomes. On the other hand, growth stocks are more risky than income stocks. There are many companies who invest their earnings for company’s growth and pays off dividend after earning a good profit which is generally a higher return. Therefore, such stocks are often called growth stocks.

Stocks on the basis of risks, this indicates that there are few stocks which are riskier than others because their share prices fluctuate more like blue-chip stocks. These are the stocks of well-established companies with stable earnings.
Lastly, stock on the basis of cyclic trends includes cyclical stock and defensive stock. There are companies which are affected by cyclical fluctuations like during booming economy their growth increases but slows down during downsizing of the economy. Therefore, price of stocks also varies according to the cyclical fluctuations; they rise during boom period and falls when economy slows down.

Prominent study was conducted by Gupta (1981) ‘Return on New Equity Issues’ which focused on the difference between returns from new issue of equity shares and return from existing equity shares. He suggested the investors that return from new issue of equity shares which includes dividends and capital appreciation particularly of new companies should be analyzed separately because the rate of return on new issues is different over time.

A study was conducted by Rao and Bhole (1990) examined the rate of return from equity during short run as well as in the long run. They analyzed that rate of return from equity in the long run turned to be positive but on the same time real return in the short run were often negative. Their study has shown the results that nominal total return on equities in India has increased but as compared to rate of inflation the real return on equity has been found negative.

A study was conducted by Raman (1995) examined the importance of equity research. While making a decision related to investment in shares, one should do fundamental analysis and equity research. To support this statement he also focused on margin of safety i.e. investor should focus on the value with a margin of safety in relation to the price. The gap between price and value is known as margin of safety, hence he opined the investors that if investor needs good and positive returns, they should also consider margin of safety. In his study he
also revealed that there is absence of qualitative communication, unchecked price rigging and free flow of information which makes the Indian stock market inefficient. Therefore, he concluded that only quality equity research can improve the investment returns in the Indian stock market.

**Damodar’o (1993)** examined the derivatives particularly the ‘futures’ which act as a tool for short term risk control. The main objective of finance manager is to manage or reduce the risk therefore; he suggested that derivatives are most the essential tool for finance managers. ‘Financial Futures’ are the most valuable instrument when risk control is needed for short term (i.e. for less than 1 year). These instruments are easily available as well as at less cost which make them suitable for short term trading and helps in managing risk more effectively.

A research was conducted on derivatives by **Venkataraman (1994)** he disclosed the positives and negatives of derivatives. If complete implications of derivatives are not known then derivative products can result into a risky situation. Moreover, if the trading part is analyzed, then derivative products are traded more in comparison to cash market products. Therefore, he brought the focus of investors on ‘Over the Counter’ (OTC) which is traded across the country. The products of Over the Counter i.e. futures and options serves as a perfect hedge for the investors.

Further **Joshi (1999)** examined that how efficiency of derivatives can reduce risk. In his study, he opined to investors that derivatives can reduce risk but due to abstruse nature of the investor they tend to lose. He concluded his study by saying that if the trader fails to analyze the leverage that the derivative offers; it could land up burning his investment.
Rao and Thakur (2004) also examined about the implications of derivatives. He talked about how derivatives help in hedging and even SEBI has recognized that speculation in the market in context to derivatives is necessary because a good market cannot function without speculation.

Dudley and Hubbard, (2004); Turner, (2002) analyzed “that bonds play a very crucial role in the market as it helps in supplying long-term funds for the growth of the infrastructure or other sectors to fulfill long-term investment needs. Similarly as the costs of equity, it can also lower the funding costs of the firm due to a liquidity premium in the secondary market. Hence we can say that, bonds provide diversity in financial products with the flexibility to meet the specific needs of investors and borrowers. They also help in providing the wide range of financial instruments available in the system, which can help in increasing the efficiency of the financial system.”

In 2007, Statistics from the NSE showed that “retail investors have been the largest participants in the derivatives markets in the past four-five years, accounting, on average, for around 60 per cent of all derivatives based activity.”

Kamlesh and Meetu (2013) have discussed about the derivatives market in India. Since 1991 economic reforms, many initiatives has been taken to make trading process user friendly for the investors but still there are many issues like lack of economies of scale, tax and legal bottlenecks and so on. Therefore, in this study they have said that if solutions of such issues are implemented in the market then definitely it will boost the investors’ confidence in Indian derivative market which will consequently lead to more growth and development in derivative segment.
**Shalini and Raveendra (2014)** focused on the position of derivatives in Indian Stock Market. Derivatives are considered as risk control or risk management tool. Therefore to analyze the position of derivative, they have considered the growth pattern of NSE and BSE in derivatives. Further they added that when during 2000, equity derivatives was introduced, Indian market experienced very high growth and NSE alone records 99% of derivatives trading in Indian Stock market. To conclude, they said that there is very immense and major contribution of derivatives in financial system.

**2.5 Studies on Indian Capital Market**

Investors who want to invest their wealth for long-term, deals in capital market. Now days, capital market has been modernized and computer based electronic systems has been adopted. Similarly, NSE has also adopted trading system for capital market segment known as the National Exchange for Automated Trading-Capital Market (NEAT-CM). NEAT is an online screen based trading system which is fully automated, nationwide and anonymous and order driven. Under this trading system, trading member can make the transactions by just punching into computer, finding the securities and their relative prices and transaction would be executed as soon as it finds a matching sell or buys order from a counter party. There are many advantages of trading online as it improves operational efficiency by reducing cost, time and risk of error. Screen based trading system also increases informational efficiency of stock markets as it allows faster incorporation of price information. Along with this screen based trading is transparent in nature and it provides liquidity as large number of market participants can trade from any location, irrespective of their geographical areas. And if in case any participant wants to resolve some dispute, this can be done easily by just logging in
‘trade execution process in entirety’. Therefore there were many trading platform of capital market segment.

As 1991 was the year when New Economic policy was introduced in India there were many policies been changed by the government and at that time a study was conducted Anshuman and Chandra (1991) studied that “the small shareholders was being favored by the government policy in terms of allotment of shares. They disagreed with such a policy because it caused various lacunae such as higher issue and servicing costs and lesser vigilance about the functioning of companies because of inadequate knowledge. After this study they suggested that for better functioning of Capital Market there is a need to eliminate this bias which would help in strengthening investor protection. With comparative allocation being advocated by SEBI, a shift in the policy is already apparent. However, there appears to be some re-thinking on proportional allocation after the recent experiences which clearly demonstrate that such a policy could result in highly skewed ownership patterns”.

Singh (1994) conducted a study titled, “Indian Capital Market - A Functional Analysis”, which depicts that the “primary market is the permanent source for supply of funds. It mobilizes the savings from the different sectors of the economy like households, public and private corporate sectors. The number of investors increased from 20 lakhs in 1980 to 150 lakhs in 1990 (7.5 times). As the number of investors increased the contribution of the securities raised from 35.01% in 1981 to 52.94% in 1989. With this, the contribution of debentures / bonds increased significantly from 16.21 per cent to 30.14 per cent.”

One of the studies was conducted by Bhole (1995) who has discussed about the trends in capital market of India. In his study he analyzed that during 1980’s public was preoccupied
with the industrial securities rather than being obsessed for securities. Moreover he focused that during implementation of New Economic Policy in 1991 there was growth in the equity culture which acted as a good cure for the economy. Irrespective of fluctuations in 80’s and 90’s in equity market there was an increase in the investors preference i.e. investment preferences was shifted from deposits to industrial securities.

Further a study was conducted on preferences of investors in India by Nagaraj (1996) he also analyzed in his study that the preferences of investors has shifted from deposits to investment in capital market. He also identified that there was change in the composition of domestic finance i.e. people of India shifted their bank deposits to investments in shares and debentures. This activity resulted into growth in capital market.

A wide study was conducted by Riedel (1997) in which it was examined the integration of capital market in developing Asia for the period of 24 years i.e. 1970 to 1994. The variable considered for this study was net capital flows, portfolio equity flows, bond flows and FDI. In this study, he analyzed that during 1990’s when economic reform was introduced, mainly in trade and financial sector it lead to capital market integration in Asian developing countries and along with this he also concluded his study by saying that to minimize risk and maximize the benefits from international capital market there is requirement to strength the process of economic liberalization in the Asian developing countries.

Bekaert (1998) “explored the link between capital market integration and economic growth. They argued that investment projects in segmented capital markets are likely to have higher discount rates because the required rate of return on equity is linked to the local market volatility. They provide new empirical evidence that the openness of the economy is
positively correlated with economic growth. Hence a capital market is an engine for economic growth.”

**Bajpai (2006)** focused on how Indian capital market has been changed. There has been a diversified change like many new investment choices has been made available for the investor, introduction of new fundamentals and structural changes, reduction in the cost of transaction, improved efficiency, transparency, safety as well as integration with the global markets. Therefore, he concludes that all these enhancements have made capital market a growing sector in the economy.

Another remarkable contribution in capital market was made by **Shelly (2010)** in her report “A Project on Capital Market”. In this report she examined the relationship between corporate earnings and investment in capital market. In her study it was found that performance of corporate earnings has a direct impact on capital market. If a company is earning good amount of profit that means in the economy there is demand of goods and services being produced and economy is growing. But if company is not earning profits then it will have a negative impact on capital market. This shows that slow growth of economy and during this situation people will not invest in capital market and it will lead to bear market.

**Ahuja (2012)** has examined the Indian Capital Market. She has observed that how Indian capital market and its structure has been changed in the last decade i.e. since 2002. Many new reforms have been introduced and several developments in Indian capital market have made Indian capital market internationally comparable. Various new innovations have made capital market more growing like surfacing of private corporate debt, modern market infrastructure
and many more. But during this study market delivered the slow performance due to the global financial crisis that was originated from US sub-prime mortgage market.

**Pasha Shaik (2012)** examined that capital market and how it has been improved with the establishment of SEBI. Their study says that as capital market is a vast market therefore, SEBI should monitor capital market rather than to over regulate it. Now, SEBI should not regulate day-to-day operations rather it should be more visionary. SEBI can take Indian capital market to international markets in the next round of reforms. They also suggested SEBI to have a balance between cost of regulation and market development.

**Shallu (2014)** studied the impact of SEBI on the development of Indian Capital Market. She has concluded in her study that, with the establishment of SEBI, capital market has been developed a lot, more transparency has been introduced in the stock exchanges. But still investors are hesitant in investing under capital market. Finally, concluded that SEBI has transformed Indian stock market but at a slow rate.

**Richa and Goel (2014)** discussed about the trends in Indian capital market and issues & challenges of capital market which are faced by an investor. They found that there are many challenges related specially to bond market. Hence they concluded that there is a need of more innovations and reforms in capital market. They also said that there is a ‘positive correlation between finance and economic growth of a country’. Lots of activities have to be completed to develop equity market but there is more need to develop bond market. Hence, some new reforms are required to remove bottlenecks, new policies are required to strengthen the bond market in India.
John et. al (2014) “has studied the recent capital market activities conducted in the developing countries. The survey of this study has focused on the experiences of three regions i.e. Southeast Asia, Latin America and Sub-Saharan Africa. The sections which were included in the research were developments in public equity markets, private equity, bond markets and efforts to integrate capital markets at the regional level.”

Another prominent part comes from Ahmed (2015) who made an analytical study on Indian Capital Market and discussed the loopholes in Indian Financial System. He examines the efficiency of capital market in pre reform period and post reform period and concludes that efficiency has been improved in the capital market after the economic reforms as well as financial sector has become more transparent. After the reforms Indian capital market was made comparable with the International markets. In this study it was also found that introduction of innovation made a remarkable change in the capital market. Emergence of private corporate debt market was one of the good innovations which replaced banking mode of corporate finance. In recent years many innovation has been brought up in Indian capital market. Finally their research was concluded by saying that there is a positive correlation between finance and economic growth. Hence, quality innovation can bring an incredible increase in economic development.

Remarkable study on European Capital Market Unions was contributed by Anderson et. al (2015). Their study concluded that Capital Market Unions can support economic growth along with economic stability. They considered various parameters to reflect how economic growth can be stabilized. By better matching of borrowers and savers which leads to efficiency in the market, private sector risk sharing, better matching of investors to financial risk, increased flow of investment from international markets can bring economic growth and
economic stability. In this study the major two highlights were bringing borrowers and investors to the market.

With the above studies till now, we can say that capital market was playing a very major role in an economy from allocation of capital and risk to policy making. It has been considered that capital market is the best canal which can route savings into long-term productive use. Hence India’s capital market in terms of GDP (Gross Domestic Product) rose from 75% in 1995 to 130% of GDP in 2005.

2.6 Studies on Stock Exchanges

Stock exchange is an organized market for the individuals as well as for the organizations for trading their securities. Any individual or an organization, who seeks to make an investment so that they can properly utilize their reserve funds, can be done by purchasing the securities. Hence we can say that, stock exchange helps in trading the securities for the investors. Stock exchange is established with some set of rules i.e. they have to promote and maintain fair transactions, transparency and efficiency in trading. This helps in developing stock exchange more beneficial for the public. “The stock exchange also provides liquidity and price discovery that facilitates efficient rising of capital for businesses, benefits the wider corporate sector and the economy in general. Therefore, as Lee (2002, p.19-20) argued, it would be inadequate to think of the stock exchange as a black box. Approaches that analyze the stock exchange as a trading system and ignore its inner structure are not rich enough to explain the impact of its performance.”
“From the point of view of Greenwood and Jovanovic (1990) a new stock exchange can increase economic growth by aggregating information about firm’s prospects, thereby directing capital to investment with returns. These effects of a stock market opening result in a measured increase in productivity. Stock exchanges exist for the purpose of trading ownership rights in firms, and a new stock exchange may increase productivity growth for this reason as well.”

It is always said that to be in the list of success one has to adopt new techniques and should introduce innovation in ones’ organization. Similarly, without adoption of innovation and technology stock exchanges also cannot work. To compete with new entrants even stock exchange has to adopt innovation. Innovation can solve many problems of the organization and can help in better growth and development. ‘Innovation within the institution itself requires the establishment of attitudes and systems that recognizes and reward creativity’ (Mason, 1991). Even National Stock Exchange (NSE) was introduced with the new concept known as demutualization which was a new innovation in the world of stock exchange.

“According to North (1991), the creation of a stock exchange can increase economic growth by lowering the costs of exchanging ownership rights in firms, an important part of some institutional stories of economic growth. Another important contribution of stock exchanges to economic growth is through global risk diversification opportunities they offer. However, Paul (1992); Deveraux and Smith (1994) and Obstfeld (1994) argue quite plausibly that opportunities for risk reduction through global diversification make high risk, high return domestic and international projects viable, and, consequently, allocate savings between investment opportunities more efficiently. Stock prices determined in exchanges, and other publicly available information help investors make better investment decisions. Better
investment decisions by investors mean better allocation of funds among corporations and, as a result, a higher rate of economic growth. In efficient capital markets prices already reflect all available information, and this reduces the need for expensive and painstaking efforts to obtain additional information (Stiglitz, 1994).”

A study was conducted on different stock exchanges in India by Amanulla and Kamaiah (1995) “attempted to compare the market efficiency of Bombay, Madras, Calcutta Stock Exchange and Ahmadabad and Delhi Stock Exchanges by using market integration approaches. The results showed that there is no evidence in favour of market efficiency of Bombay, Madras and Calcutta Stock Exchanges, while the results confirm the existence of market efficiency in Ahmadabad and Delhi Stock Exchanges. It was assumed that market efficiency was due to quick transmission of information along with reliable operational efficiency. Thus rapid informational network and operational efficiency may pave the way towards market efficiency. They considered the provision for liquidity of capital and continuous market for securities as prime functions from the point of view of investors. In an efficient market, all the appropriate information about a firm that is obtainable to market participants is expected to be fully and instantly absorbed and reflected in its share price.”

“One of the papers that relate the organizational and ownership structures and stock exchanges is that of Hart and Moore (1995). Hart and Moore noted that many stock exchanges differ from commercial organizations as they are governed by member’s cooperatives. That is they are run on behalf of the people who use the exchange. The paper distinguishes between the cooperative structure and outside ownership based on who has residual rights or control over the non-human assets. In case of outside ownership, control rests with the owners; and in case of member cooperatives, the members have collective
control. Outside owners are typically only interested in maximizing profit; they tend to make inefficient decisions, tailored to the marginal user. By contrast, in a cooperative the members have collective control. Collective decision making is typically inefficient, because in a vote the views of the pivotal voter do not necessarily represent those of the membership as a whole. Thus both types of governance are inefficient for different reasons. The analysis of Hart and Moore suggest that the relative merits of the two forms of ownership depend on the level of competition between exchanges and the diversity of interest of the stock exchange members. The greater the diversity and greater the competition, the more likely that outside ownership will become more efficient than a member’s cooperative.”

A study was conducted on the linkage between prices of National stock exchange and Asian industries by Masih (1997) in this study they considered four Asian industrializing countries i.e. Taiwan, South Korea, Singapore and Honk Kong. In their research they concluded that there is a linkage between them. The markets are not mutually exclusive in fact they are related to each other and short-run linkages appear to run them.

“One paper that analyzed the organizational structures of stock exchanges is that of Pirrong (2000). Pirrong presented a model that identifies the factors that determine whether exchanges are organized as a for-profit enterprises or non-profit enterprises. His analysis is based on two assumptions; that members of an exchange are profit maximizers and that exchanges have some market power. Pirrong argues that the rules governing the trading process can impact the organizational structure of the exchange. One way is that the exchange can charge a ‘super-marginal’ cost for its services and distribute the profits to its members. In this way, the exchange is operated as a for-profit enterprise. Another way is for the exchange to set prices for its services that are equal to marginal cost, and establish rules
that enforce cartels among stock exchange members and limit the number of members. The stock exchange then is labelled as a non-profit mutual organization.”

A study was conducted by Aggarwal (2002) on ‘Demutualization and corporate governance of stock exchanges’ under which various stock exchanges were examined to analyze the impact of demutualization on stock exchanges. Mainly, London Stock Exchange and Australian Stock Exchange were considered for this study. It was analyzed that demutualization was driven because of increased global competition and advancement of technology. Hence, when demutualization was implemented, the corporate governance of stock exchanges was improved along with the improvement in the performance of stock prices.

Krishnamurti et. Al (2003) “has compared two stock exchanges operating in India with different corporate governance structures. Bombay Stock Exchange (BSE) was a non-profit cooperation at those times, while National Stock Exchange (NSE) was a demutualized exchange. Both exchanges had similar operating systems. By using ‘Hasbrouck’s measure of market quality’, the researchers found out that NSE is better than BSE by means of corporate governance.”

Due to economic activity there are chances of arising unwanted problems which cannot be solved automatically by the market. Problems like; incomplete contracts which results into increasing cost, market effects on third parties and so on. Hence, for such issues regulating the stock exchange becomes an important aspect. Hence, “The International Organization of Securities Commissions (IOSCO) provides three main objectives for securities regulation. These are: 1. the protection of investors, 2. the creation of and maintenance of fair, efficient
and transparent markets, and 3. the reduction of systematic risk. *(IOSCO, Objectives and Principles of Securities Regulation.)*

One of the major studies related to stock exchange were by **Sinha and Pan (2007)** analyzed “the nature of fluctuations in the Indian financial market. They have studied the price returns of individual stocks, with tick-by-tick data from the National Stock Exchange (NSE) and daily closing price data from the two largest exchanges in India National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). They found that the price returns in Indian markets follow a fat-tailed cumulative distribution, consistent with a power law having exponent $\alpha \sim 3$, similar to that observed in developed markets. However, the distributions of trading volume and the number of trades have a different nature than that seen in the New York Stock Exchange (NYSE). Further, the price movement of different stocks is highly correlated in Indian markets.”

**Mukherjee (2007)** has “made a comparative analysis of global stock market i.e. in his study he has taken Indian stock market as one variable and other variable as International stock market. Further, he has covered NYSE (New York Stock Exchange), HSE (Hong Kong Stock Exchange), TSE (Tokyo Stock Exchange), RSE (Russian Stock Exchange), KSE (Korean Stock Exchange) under International Stock Market whereas BSE (Bombay Stock Exchange) and NSE (National Stock Exchange) has been covered under Indian Stock Market. The parameters considered for making a comparative analysis between Indian stock market and International stock market was studying the trends, similarities, movements and pattern of activities which include market capitalization, number of listed securities, listing agreements and settlement. Therefore, in his study the conclusion was that markets react to global cues and any happening in the global scenario be it macroeconomic or country specific affect the various activities”.

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Kumar and Gupta (2009) “have analyzed the growth pattern of NSE. The study was for the period of twelve years i.e. from 1995-96 to 2006-07. It was found that all the segments of NSE have registered splendid growth in terms of turnover. The derivatives segment of NSE has made it one of the largest stock exchanges in the world. So far as the trading in securities is concerned, it is not broad based. The trading is concentrated to few securities and a large portion of the securities were experiencing low liquidity.”

Adhikari (2010) examined that companies with unique business models were got listed under National Stock Exchange in the year 2009-2010 which make their investors rich and along with that Mehra (2010) also studied that promoters of such companies are in a hurry to IPO the shares because they do not want to be left out.

Indrani (2010) “analyzed the determinants of the capital structure of Indian firms using a panel of 1169 non-financial firms listed in either the Bombay Stock Exchange or the National Stock Exchange over the period 1995–2008. This study was conducted by using capital structure theories.”

Singh and Kaur (2011) “examined the growth and performance of turnover in Capital Market Segment at NSE for the period of 1994-95 to 2009-10. Through this study they analyzed that capital market of NSE has been growing continuously and this was examined by seeing the turnover of the capital market segment. They have also compared trading of NSE with the other stock exchanges in India and found that NSE contributes maximum in trading of securities. This is because NSE has completely mechanized trading system.”
Arora (2012) examined the performance of two most prominent stock exchanges of India; National stock exchange and Bombay stock exchange. Study was conducted by analyzing and comparing the services being provided by the depositories and performance of NSE and BSE has been compared by taking 100 companies.

Sarioglu and Eren (2012) conducted a study on ‘Changes in the corporate governance and ownership structure in stock markets: Demutualization of Istanbul Stock Exchange’. In this study the researcher examines the pros and cons of demutualization as to suggest whether mutual Istanbul stock exchange should be demutualized or not. While this study, it was examined that demutualization has brought very significant changes in the stock exchanges as it improves the corporate governance of the stock exchange as well as it also helps in improving the financial condition of the stock exchange. Demutualization helps in increasing the efficiency in the management which stimulates the trust and confidence of investors to the capital markets.

Bala (2013) “has studied the role of stock exchanges in India before and after independence. The study reveals that joint stock sector companies cover the forth-fifth of the total listed stocks. The study concluded that investment in securities was no longer the monopoly of any particular class or of a small group of people. It engrossed the attention of a large number of 24 small and middle class individuals. It was observed that a large proportion of savings went in the first occurrence into purchase of securities already issued.”

Bose et. al (2014) in their study ‘Measuring and comparing the efficiency of Dhaka Stock Exchange and Chittagong Stock Exchange’ analyzed the market efficiency of two exchanges
i.e. Dhaka Stock Exchange and Chittagong Stock Exchange. In this study, relationship was examined between the information and share prices of capital market.

Mishra (2015) has analyzed the trading statistics of different stock exchanges available in India. To study the concept she examined the Indian capital market and its trend in globalised economy along with the challenges of Indian capital market. Through her study she concluded that, as capital market is a crux of any economy, hence it is very crucial to enhance the market for the betterment of an economy. Moreover she also suggested that one should invest in stock market because of the availability of diversified portfolio at low cost with transparent trading in stock exchanges. And lastly, she concluded her study by saying that SEBI has worked a lot for the better trading in capital market but at slow rate in comparison to global competitive markets.

Paltrinieri (2015) has examined the reason for merger between Dubai Financial Markets, Nasdaq-Dubai and Abu Dhabi Securities Exchange. The study revealed that ‘contraction both in market capitalization and in trading value in the three UAE stock exchanges was caused by subprime financial crisis and market fragmentation’ and this caused a merger between them.

Roopa (2016) brought into the focus a very interesting point in her study on ‘Quality in Governance of Demutualized Stock Exchanges over Mutualized Stock Exchanges–A Case Study’. In this study, two most prominent stock exchanges of India; National Stock Exchange and Bombay Stock Exchange were analyzed. The focus was on quality of markets and governance of stock exchange. This study concluded that NSE is having better quality market that BSE. It says that NSE has played a very crucial role in transforming Indian stock markets by adopting innovative technology and hence reducing the cost for the benefit of investors.
2.6.1 Performance Measurement

“Performance measurement is a very broad topic, but literally it can be defined as the process of quantifying action. Performance measurement can also be defined as a metric used to quantify the efficiency and/or effectiveness of action. This can either be expressed in terms of the actual efficiency and/or effectiveness of an action or in terms of the end result of that action. Therefore, it is necessary for the performance system to be quantified to state clearly things like the title of the measure, how it will be calculated (the formula), the responsible parties of carrying out the calculations and the sources of Data (Neely, Andy et al, 1995).

According to Fitzgerald and Moon (1996), non-financial indicators such as quality, customer service, innovation, and flexibility – should also be used to study the external and internal corporate strategy. Fitzgerald and Moon developed a framework using the management and accounting literature – that has three building blocks: dimensions, standards and rewards. This framework tackles three issues: the dimensions of performance that need to be measured, 2. the standards for these measures and, 3. the rewards that are linked to the achievement of these standards. According to this framework, performance indicators are categorized into six generic dimensions; 1. Competitiveness 2. Financial performance 3. Quality of service, 4. Resource utilization, 5. Flexibility and 6. Innovation. These six generic dimensions distinguish between two categories; Measures that reflect the results of actions (the chosen new strategy) (financial performance and competitiveness) and measures that reflect the factors (determinants) of future performance.

Focusing performance measurements on the traditional financial and cost management dimensions has devastating effects on the performance of the enterprise on the long-run. As
Martin noted, traditional financial measures act as barriers to the achievement of increased stockholder value, higher quality, lower cost and speed to market because they give false signals as to the actual position of the corporation’s performance (Martin, 1997).

Ames (2002) in this study it was said that management is an asset for the organization and to have well managed assets it is necessary to have skills to deal with it. Moreover, asset is variable in nature. This study also explained that financial status is very important for the firms and they are heterogeneous in nature. Financial firms deals with different products from the given assets.

Lee (2002) stated that the aim of stock exchange has been shifted from satisfying financial intermediaries to market participants and this is due to high competition in the market. Moreover, due to technological advancement, a stock exchange has to adopt changes. With this stock exchanges adopted demutualization and self-listing and there was better financial condition of stock exchanges. In addition to this, demutualization also enhanced financial decision and better allocation of resources. Thus, we can say that this change made the stock exchange perform better than expected and financial performance of stock exchange was enhanced.

O’Hara and Mendiola (2003) “the financial performances of the demutualized and listed stock exchanges have been investigated. The stock exchanges were Singapore, Athens, Deutsche Börse, Euronext, Australian, Hong Kong, London and NASDAQ. The financial performance was divided into four components: Accounting-based, return-based, risk based and the comparison of the exchange with the economic variables. They have calculated the return on asset, return on equity, operating margin, asset turnover and financial leverage of
the exchanges before and after the demutualization process. According to the findings of this study, the demutualization did not seem to increase the performance of the exchanges in regards of accounting-based measures. However, in the means of return-based measures, the returns of demutualized exchanges were greater than their market indices.”

“Many other studies were conducted on demutualization and its impact on financial performance of stock exchanges or on other market measures. Few of the studies are of Serifsoy (2005) who conducted an efficiency analysis that focused on the exchanged governance, Krishnamurti (2003) who compared trading costs for two major stock exchanges in India; the demutualized National Stock Exchange and the mutualized Bombay Stock Exchange, Treptow (2006) presented a detailed analysis on the impact of demutualization of securities exchanges on liquidity through examining securities that were listed on two markets simultaneously, Hazarika (2005) examined the impact of demutualization on trading volumes and costs and consider this impact in two different situations; in which competition plays a major role, Worthington and Higgs (2006) studied market risk in four demutualized and self-listed stock exchanges.”

Otchere (2006) examined the performance of self-listed exchanges and non-listed exchanges. His study revealed that operating performance of self-listed exchanges is much better than non-listed exchanges. Even they outperformed the stock market indices. Therefore after seeing the results of study, many non-listed exchanges were converted into self-listed exchanges.

One of the prominent studies was done by Saadi-Sedik, Tahsin, and Martin Petri (2006) on the performance of Jordan Stock market. In their study, analysis was done on the
performance of Amman Stock Exchange (ASE) and its integration with other stock markets and it was found that Amman Stock Exchange is cointegrated with other Arab Markets. It concluded that Jordan stock market should enhance their transparency and effectiveness of regulation of its capital market so that it can create a different identity from other stock markets.

“Of particular importance is the impact of demutualization on the financial performance. Shareholders (equity capital providers) provide money in return for a claim on profits. Since the return on the assets they provide (capital) is the residual earnings or profit of the firm, then their return cannot be guaranteed without ensuring that the firm’s financial performance is strong. In other words, the firm’s wealth must be created before it can be distributed to the various stakeholder groups, Boatright (2006). In order to compete efficiently, stock exchanges must operate for-profit. The new recent technological changes have made the members’ ownership structure less appealing.”

Baris (2007) in his study he made a ‘comparative analysis on technical efficiency and factor productivity of exchanges by using different business models. 28 stock exchanges were considered for the study and for the period of 1999-2003. Findings suggested that exchanges that diversify into related activities are mostly less efficient than exchanges that remain focused on the cash market.’

Otchera and Khaled (2008) examined the performance of listed exchanges and quality of stock market in reference to Australian Stock Exchange. The study revealed that performance of Australian Stock Exchange was improved within 5 years of demutualization and self-listing. The profitability ratios were improved and even trading activity was enhanced after
demutualization and self-listing. The conversion of Australian Stock Exchange from mutual to demutualization resulted better and enhanced stock exchange for its shareholders as well as for stock market.

*Njanike et. al (2009)* ‘Factors Influencing The Zimbabwe Stock Exchange Performance’. An interesting study was conducted to analyze the factors which affect the performance of Zimbabwe Stock Exchange and it was revealed that its performance was majorly influenced by monetary policies framed by reserve Bank of Zimbabwe. Along with this money supply and inflation has also been an important constituent in improving stock market development. Beside this, their study also suggested investors to keep a track on factors which influence their investments to have a good outcome.

*Arwa (2010)* examined the financial performance of stock exchange. The performance was analyzed in pre and post period of demutualization. The duration of study was between 1996 and 2004. To study the performance of stock exchange after demutualization 11 measures were considered and only 4 out of 11 financial measures resulted in showing change in performance. The ratios which were considered for measuring financial performance were current ratio, asset management ratio, debt management ratio, and profitability ratio and control analysis.

*Islam (2010)* examined the impact of demutualization on the financial performance of stock exchange. The result showed that after the conversion of stock exchange from mutual to demutualization the performance has been much better and improved in comparison to earlier years. The study was conducted for the period of 1996-2008. Moreover, after demutualization there was an increase in size and liquidity of stock exchange.
Morsy and Rwegasira (2010) examined the impact of demutualization on market performance of stock exchanges. The study was done for the period of 1993-2004. The study was analyzed by examining 16 market measures in pre and post demutualization period. The result was that only 7 measures affected the market performance of stock exchange. The study also revealed that major areas of stock exchange i.e. equity and bond market were not improved after demutualization.

Angulo et. al (2014) in their study revealed that London Stock Exchange improved its financial performance after adoption of demutualization. Due to increase in competition and technological advancements, London Stock Exchange was forced to demutualize. But demutualization brought efficiency along with the improvements in corporate governance of London Stock Exchange.

Itoe et. al (2016) contributed a very outstanding study on the performance of Doula Stock Exchange. The study was conducted for the period of 10 years i.e. from 2006-2015. They concluded that stock exchange is a guide for investors to invest and helps in financial decision for making prominent decisions. Moreover, they said that Doula stock exchange market contributes positively to economic growth of Cameroon and this positive sign was seen after the stock exchange introduced government treasury bond in the year 2010.

Therefore from the above studies it can be conclude that capital market is the heart of an economy through which we can channelize our savings into effective long term investments. A developed capital market will contribute in the economic growth and development of the country. With respect to this, the standards established by NSE in terms of market practices
and technologies have been turned up as a benchmark and are being emulated by other market participants.

Studies reflected that capital market has been improvised with the development of SEBI and has become more transparent and efficient with the establishment of National Stock Exchange. Few studies resulted that NSE contributes maximum in trading of securities in comparison to all other stock exchanges available in India. Moreover derivative segment of NSE has made it one of the largest stock exchanges in the world and all the segments of NSE have registered splendid growth in terms of turnover.

The review of the available literature shows that although there are number of studies on different aspects of capital market, fluctuations in Indian market, stock market efficiency, rules for investors to invest in capital market, market efficiency of various stock exchanges in India, capital market in pre reform era and post reform era, role of SEBI and its impact on capital market, positive and negatives of derivatives and position of stock exchanges in pre and post Independence, contribution of different stock exchanges in trading but no such study has been conducted on the ‘Role of National Stock Exchange in the development of Capital Market.’

2.7 Key Observation and Research Gap

In this chapter, the researcher has covered the studies related to efficiency and liquidity of stock market, studies on equities and derivatives, Indian Capital Market and different stock exchanges. The researcher studied approximately 97 studies out of which only 20% of studies were related to Indian stock exchanges. Around 40% of studies were related to equities and
derivatives and rest on different patterns on stock market. It can be evident from the above contents that no study has taken place on the ‘Role of National Stock Exchange in the development of Capital Market’, further more the researcher has not witnessed studies answering how the National Stock Exchange has performed financially, how financial performance has been through the years since it has been established, how equity trading has grown, what are the trends of growth in Capital Market segment of NSE, how internet trading has created an impact on trading volume or what is the ratio of internet trading in comparison to total trading in NSE. In context of Indian Capital Market, a couple of studies have been conducted to compare BSE and NSE stock market volatility, liquidity and efficiency of stock market, however they have been conducted for a small period of time and not in depth. Hence, it is apparent that examining the overall ‘Role of NSE in the development of Capital Market’ which will focus on the financial performance of NSE from 2006-2007 to 2015-2016, growth pattern of equity segment, comparison of internet trading with the total trading at NSE and to suggest how NSE can improve its financial performance for further growth & promotion of Capital Market in India. Therefore it can be said that it is a valid research gap.

2.8 Conclusion

In a nut shell, available literature shows number of studies on capital market, Indian market, stock market efficiency, rules for investors to invest in capital market, market efficiency of various stock exchanges in India, capital market in pre reform era and post reform era, role of SEBI and its impact on capital market, positive and negatives of derivatives and position of stock exchanges in pre and post Independence, contribution of different stock exchanges in trading but no such study has been conducted on the ‘Role of National Stock Exchange in the development of Capital Market.’
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