CHAPTER - X
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CHAPTER-X: SUMMARY, FINDINGS, SUGGESTIONS AND CONCLUSION

SUMMARY

Indian Capital Markets have shown tremendous growth in the period between 2003 and 2011. It remains one of the most resilient globally and poised to be one of the Top destinations for domestic and global businesses to expand and invest into. As global economy moves for imminent recovery, India has shown extraordinary strength to bounce back with greater stability and sustainability.

Raising capital is a strategic priority across India and role of Capital Markets have assumed far greater importance and urgency. The Debt market still needs to be developed to invite capital inflows needed for massive infrastructure development. The frontiers of global markets are not only increasing but also moving towards process of convergence.

Firms inflows followed by Domestic Financial Institutions / Banks, Insurance Companies and Mutual Funds have been playing a major role in terms of Institutional Inflows into Capital Markets. Though Venture Capital Funds and their investments are much talked about, but their contribution in terms of volume of investments is insignificant. The steep rise in number of retail individual investors and domestic corporates have brought into focus further issues of corporate governance and investors protection more prominently. The efforts of the Regulators and the Government to protect the interests of investors in securities and to promote the development of, and to regulate the securities market towards enlightened Governance, has been lauded by all stake holders.

There is huge potential for the capital markets growth as at present just 2% of the population, account for retail investors and the lowest strata of the pyramid still remains untapped. The real inclusive growth also needs penetration of capital market to the last mile.

The growth in the economy was duly supplemented by a significant increase in the capital markets activity. There were significant changes to the legal framework, with Securities Exchange Board of India (SEBI) being entrusted with the regulatory power to govern the capital markets to ensure compliance. There was also technological advancement in the capital markets with the introduction of terminal based trading replacing the open outcry system and launch of the integrated market surveillance system, to monitor market malpractices, by the regulator.

The Corporate Governance framework was also strengthened through a series of amendments to the existing governance structure, by introduction of Clause 49 to the Listings Agreement and setting up of committees like the Naresh Chandra Committee Report on Corporate Audit and Governance. So far India has risen up to the challenge of a growing economy by ensuring that the requisite infrastructure is put in place to ensure market best practices and restore investor confidence.

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The story of growth is incomplete without the presence of governance. The strong fundamentals of an economy are based on the virtues of good governance and ethical practices.

Much has happened in the Indian capital market in the last 17 years. With its foundations laid in socialist based economy of four decades, with strict government control over private sector participation, foreign trade and foreign direct investment, India opened its gates to the outside world in the early '90s. Since then its economy and financial markets underwent radical changes, largely in response to the economic crisis of the late 1980s. The government control on foreign trade and investment were loosened and the barriers to entry in the days of the license raj were relaxed.

The emergence of Securities and Exchange Board of India (SEBI) as the supreme capital market regulator showed India's commitment to come across as a strong economic force through establishing market best practices of enhanced corporate disclosure and increased investor protection.

The establishment of National Stock Exchange (NSE), a state-of-the-art exchange, with sophisticated technology to improve trading practices and reduce unethical dealings, supported by a strong legal framework and technological base to strengthen the governance structure, has been the highlight of the Indian capital market in the last decade. The opening up of the economy has increased the flow of Foreign Direct Investment (FDI) and Foreign Institutional Investment (FII) has put India on the global map, as a new-age economic force to reckon with.

The increased level of sophistication in the market has been duly supported by increasingly complex instruments like derivatives and other structured products. While, the recent global meltdown has made us aware of the perils of sophisticated markets, the learning has been to follow a path of caution while maintaining a steady pace.

Several steps have been taken by the regulator to enhance the level of corporate governance and reporting requirements of the Indian stock market. Significant legislation has taken place in this area to curb market malpractices. The large scams and frauds have taught us that growth without a robust governance structure falls short of global expectations. The regulators have been active in responding to such events and in certain cases have undertaken proactive measures to stop such events from recurring.

The introduction of free pricing in the primary capital market has significantly deregulated the pricing control instituted by the erstwhile CCI regime. While, the issuers of securities can now raise capital without seeking consent from any authority relating to the pricing, however the issuers are required to meet the SEBI guidelines for Disclosure and Investor Protection, which are now known as ICDR Regulations, which, in general, cover the eligibility norms for making issues of capital (both public and rights) at par and at a premium by various types of companies.

The freeing of the pricing of issues led to an unprecedented upsurge of activity in the primary capital market as the corporate mobilized huge resources. However, it did expose the inadequacies of the regulations.
In order to address these inadequacies, SEBI strengthened the norms for public issues.

1. The disclosure standards were enhanced to improve transparency and uphold the objective of investor protection.
2. The issuers are now required to disclose information on various aspects, such as, the track record of profitability, risk factors, etc.
3. Issuers now also have the option of raising resources through fixed price floatation or the book building process.
4. Clearing houses have been established by the stock exchanges and all transactions are mandatorily settled through these clearing houses and not directly between the members, as was practiced earlier.
5. The practice of holding securities in physical form has been replaced with dematerialized securities and now the transfer is done through electronic book keeping, thereby eliminating the disadvantages of holding securities in physical form. There are two depositories operating in the country.
6. The margin system, limits on intra-day, trade and settlement guarantee fund are some of the measures that have been undertaken to ensure the safety of the market. The trading and settlement cycles have been significantly reduced. The cycles were initially shortened from 14 days to 7 days. The settlement cycles were further shortened to T+3 for all securities in 2002. The settlement cycle is now T+2.

Listed companies are required to furnish unaudited financial results to the stock exchanges and also publish the same on a quarterly basis. To enhance the level of disclosure by the listed companies, SEBI decided to amend the Listing Agreement to incorporate the segment reporting, accounting for taxes on income, consolidated financial results, consolidated financial statements, related party disclosures and compliance with accounting standards.

The last few years have seen significant interaction with the international capital markets. A major step towards that was the inclusion of Foreign Institutional Investors (FIIs) such as mutual funds, pension funds and country funds to operate in the Indian markets. As a quid pro quo, Indian firms have also raised capital in international markets through issuance of Global Depository Receipts (GDRs), American Depository Receipts (ADRs), Euro Convertible Bonds (ECBs), etc.

The SEBI's regulatory realm stretches beyond the stock exchanges to merchant bankers, registrars, share transfer agents, underwriters, mutual funds and various other advisors and market intermediaries. There have been efforts made to increase transparency in the takeover process and interests of minority shareholders.
Derivative market

One of the most noteworthy achievements of the Indian capital markets over the past several years has been the development of the derivative market. It has significantly enhanced the sophistication and maturity of the market. In India, derivative trading began in June 2000, with trading in stock index futures.

By the fourth quarter of 2001, each of India's two largest exchanges had four equity-derivative products: futures and options for single stocks, and futures and options for their respective stock indices. The NSE has become the largest exchange in single stock futures in the world, and by June 2007, it ranked fourth globally in trading index futures, a sign of an evolving and maturing market.

Market liquidity too has increased greatly since 2003. This was primarily attributed to settlement rules and the introduction of derivatives trading. The move from fixed period to rolling settlements, shortened settlement periods, and a dramatic increase in derivatives trading contributed to steadily increasing market liquidity.

Technology framework

The advent of technology to the markets has been largely attributed to the National Stock Exchange (NSE). NSE introduced the screen based trading and settlement system, supported by a state-of-the-art technology platform. To fulfill the commitment to adopt global best practices and bring about more transparency to the capital markets functioning, SEBI also assumed the responsibility of monitoring the markets and stock exchanges. A significant step towards that initiative was the launch of the Integrated Market Surveillance System (IMSS) in 2006.

The IMSS equipped the regulator to identify doubtful market activity. 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 National Securities Depository, Limited. (NSDL), Central Depository Services (India) Limited. (CDSL), clearinghouses, and clearing corporations.

The RBI introduced the electronic funds transfer system, "The Reserve Bank of India National Electronic Funds Transfer System" (referred to as "NEFT System" or "System"). The objective of the system is two-fold. First, is to establish an electronic funds transfer system to facilitate an efficient, reliable, secure and economical system to transfer and clearing in the banking sector throughout India. Second, is to relieve the stress on the paper based funds transfer and clearing system.

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Given the conducive regulatory frame work, pro-active policies, the Indian Capital Markets have seen substantial inflows which have helped the industry across the sectors in attracting capital for the expansion, diversification and modernization plans of various companies forming part of sectors identified under the overall gamut of the Industry.

Considering the above aspects, the Researcher felt the need of undertaking a study on Indian Capital Markets – Sectoral Growth Trend Led by Investments between the periods of 2003-2011.

FINDINGS

Findings of the study are based on Qualitative and Quantitative Assessment for empirical evidence. Based on which, the researcher in his study has found out the following:

Investment inflows in to selected 22 sectors comprising 122 companies have been significant voluming to Rs. 2346046 crores at market price valuation.

On the Institutional Segment Side, FIIs have contributed a major chunk in terms of investment inflows followed by Domestic Financial Institutions, Insurance Companies and Mutual Funds.

Domestic Investors are also not less in terms of their contributions in the form of investments. Domestic Corporate and Individual Investors still hold a major chunk as a part of investments.

On the basis of empirical testing with the help of statistical tool, correlation co-efficient, when tested for the Impact of Investment Flows on the Sales, Profitability, Assets Addition and Investor Market Capitalization, the empirical findings are startling as high correlation existed between Investment Inflows and Sales, Profitability and Assets Addition.

The Correlation was above 90% in the case of Investment multiplication through market investments by Investors.

120 companies out of 122 total companies showed a positive correlation forming 98.36% indicating that there is a Wealth Maximization and Market Capitalization growth, when correlated with the investment inflows.

Further when the empirical testing was done with BSE SENSEX and NSE NIFTY companies’ aggregates in terms of sales, profit, assets and investors wealth creation, on all the parameters, investment inflows have shown a high correlation. The findings suggest that BSE SENSEX and NSE NIFTY companies have given multifold returns to investors.

When compared with International Markets, Indian markets are also getting influenced to a larger extent with the global major indices as global cues have become part and parcel of market volatility.

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Though Sub Prime Crisis has shakened the markets world-wide in 2007-2008 period, the effect of Sub Prime Crisis during the main crisis period on Indian Markets was minimal as the strong growth trajectory of Indian Economy made global investors confident about the markets restraining their withdrawals from India. However for various reasons of their parent companies money requirements during 2008 heavy outflows have taken place from FIIs side for them to again make a comeback in the mid of 2009.

The above findings are based on the detailed research which has been presented in the research report at length.

SUGGESTIONS

As a part of Chapter-IX, Under the title India Investments – The Way Forward and Constructive Suggestions, major suggestions have been put forward in the said chapter.

In addition to that, the Researcher would like to present the following additional suggestions in this Concluding Chapter.

The Suggestions are mainly from the angle of investor perspective for attracting further investments.

Capital account convertibility

1. Capital account convertibility (CAC) is a monetary policy that centres around the ability to conduct transactions of local financial assets into foreign financial assets freely and at market determined exchange rates.
2. India currently has current account convertibility, i.e. foreign exchange is easily available for import and export of goods and services. India also has partial capital account convertibility i.e. an Indian individual or institution can invest in foreign assets up to USD 25,000 and there are some caps on the foreign direct investment in India.
3. The First Tarapore Committee was set up by the RBI in 1997 to study the implications of executing FCAC in India. It recommended that the before CAC is implemented, the fiscal deficit needs to be reduced to 3.5% of the GDP, inflation rates need to be controlled between 3-5%, the non-performing assets (NPAs) need to be brought down to 5%, Cash Reserve Ratio (CRR) needs to be reduced to 3%, and a monetary exchange rate band of plus- minus 5% should be instituted. However, most of the pre-conditions weren’t entirely fulfilled and the idea lost steam in view of the Asian Crisis as well.
4. Over a period of time, with the improvement in India’s economic fundamentals and the importance of a flat world and financial liberalization policies, the implementation of CAC has again become a debatable issue. However there are major risks which have to be factored in.
5. There are benefits to fuller capital account convertibility for financial institutions, including increased diversification, greater access to capital, and a broader range of risk management tools. However, policymakers, financial institutions, and their clients typically face additional challenges with fuller capital account convertibility. At about USD 104 billion, total foreign bank claims on India are comparable to those on China and Russia. In contrast, Indian banks’ claims on other countries are four times less than this total. With fuller capital account convertibility, new risks will arise as cross-border transactions increase. Such activities will not only involve different currencies and span many countries but also include on-balance sheet lending and funding, as well as off-balance sheet derivatives and other complex financial transactions.

6. India needs to gear up in risk mitigating mechanism first for allowing full capital account convertibility. Till then the Current Account Convertibility Limits can be increased.

Concerns on innovative financial products

The global financial crisis across the world pointed out many realities which global investors, regulators and countries chose to ignore over a period of time. India’s financial markets were impacted to some extent by the crisis. Worldwide, major global financial institutions had to be rescued by fire sales, the financial landscape changed significantly with the collapse of Lehman Brothers. In fact the famous investor Warren Buffet labeled these products as weapons of mass destruction (WMD).

Regulators and market participants have been warning for years about the dangers of the unchecked growth of the credit default swap market and about the difficulty of assessing who could be at risk for derivative market failures.

Globally, the market saw failures to the extent of government takeover of US mortgage giants Fannie Mae and Freddie Mac, the collapse of Icelandic bank Landsbanki and, most notably, the bankruptcy of Lehman Brothers and Bear Stearns. AIG was pushed to the brink of bankruptcy last fall when a credit downgrade allowed swap counterparties to demand billions of dollars of collateral AIG didn’t have. Policymakers however, chose to rescue AIG.

India too has a INR 60,000 crore loan securitization market, in which mutual funds (MFs) have emerged as the biggest investors over the past 5 years. Thirty six odd mutual funds are estimated to have an exposure of INR 42,000 crore to all securitized products which is 8-10 per cent of the assets under management of the industry. But if you look at the share of securitized product in debt schemes, the exposure represents 25-30 per cent.

Asset Backed Securities (ABS) are totally illiquid; unlike the global markets, there is no secondary market for these securities. In India, delinquencies in retail portfolios of banks have still not reached panic levels. Nonetheless, they are inching up slowly but surely. Add that to the sudden drying up of liquidity and the domestic mutual fund industry emerges as India’s weakest link in the securitization food chain.
The bigger fear is that this exposure could have a cascading effect on the entire banking sector, with the risk getting transferred to many of the parent companies of these MFs. The dominance of mutual funds in securitization coincided with private sector banks slipping into overdrive to hawk retail loans.

Such kind of Innovative Products which are destructing the Wealth of Investors at large and Economy to an extent needs to be either banner or strictly regulated. Hence a regulatory mechanism for cross border innovative instruments is a must for the stability of Indian Financial Markets.

Hedge funds

Hedge funds typically invest in a broad range of investments, including equities, debt, and commodities; invest in many international markets; and make both long and short investments. They also generally adopt various sophisticated investment strategies using structured products.

Hedge funds typically have absolute-return investment targets and fee structures highly geared to those returns, and, most relevantly for financial stability issues, employ leverage to enhance those returns.

Available data on hedge fund assets show that they rapidly rose from about USD 324 billion in 1999 to USD 2.2 trillion in 2007, an annual average growth rate of 23%. In 2008, the total number of hedge funds fell 9% to about 10,000 (International Financial Services London 2009). The level of assets, however, collapsed to only USD 1.5 trillion by the end of 2008, reflecting declines in both market value and redemptions. Moreover, the level could have been even lower, as some hedge funds adopted "lock-up" provisions that temporarily prevented redemptions by their investors.

Most of the Hedge Funds are leveraged funds, whose investment horizon depends on Global Currency Fluctuations and Interest Rates thus making their investment horizons unreliable. Though some of the hedge funds say that their horizon is of longer tenure, but they are fair weather friendly. To combat the volatility from Hedge Funds a fixed tenure of investments may be prescribed for their investments.

Focus on eliminating the short-comings and plugging the gaps

India's Capital Market development efforts can concentrate on two major areas:

Technical issues: Technical reforms can be undertaken fairly quickly and easily. Indian authorities have already made some progress in this area, with several additional announcements expected in the coming months.

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Political issues: These would be more challenging issues that will rub up against political constraints. Progress in these areas will be slow, with the full slate unlikely to be completed for nearly a decade.

**Development of Market Oriented Debt Markets is Essential to attract more investments:**

Political commitment will be essential, though admittedly difficult, in the current climate and it would help to have one regulatory agency step forward as the debt markets champion, working in consultation with industry participants.

If India can deepen and strengthen its debt capital market, the results could be significant. Drawing on the cross sectional experience of G7 countries since the 1970s, its estimated that the overall capitalization of the Indian debt market (including public- sector debt) could grow nearly four-fold over the next decade. This would bring it from roughly USD 400 billion, or around 45% of GDP, in 2006, to USD 1.5 trillion, or about 55% of GDP, by 2016. The following issues should be kept in consideration to encourage the debt market in India.

**Cost of issuance:** Cost of issuance in terms of rating, listing, disclosure and marketing requirements makes the public issue of bond expensive, making private placement a preferred alternative for most issuers. If the corporate bond market is to develop, a great deal of attention will have to be given to minimize the issuance cost and the time taken to make public issue. There is a need to rationalize and reduce the stamp duty.

**Market making:** Market making should be encouraged for promoting the corporate debt market. This requires incentivizing large financial intermediaries like primary dealers to take up this job. One way is to encourage the investment bankers involved in the placement of the bonds.

**Listing norms:** For already listed entities, there listing norms could be simpler; they should be allowed an abridged version of disclosure. However, companies which are not listed and which are opting for the private placement mode should be subjected to stringent disclosure norms.

The practice of suspension of trading/delisting of securities in case of non-compliance with listing norms by an issuer needs to be replaced by heavy penalties on the promoters and directors of the erring company.

**Developing a trade reporting system:** A mechanism that captures all the information relating to trades in corporate bonds, disseminate the same and keeps a data base of trade history needs to be developed. Various regulators should direct the regulated entities to report all the transactions done by them to the trade reporting system.

**Trading, clearing and settlement mechanism:** A robust trading platform would go a long way in enabling efficient price discovery in corporate bonds and also help in creating depth and vibrancy to the market. An efficient clearing and settlement system would further the development of corporate bond markets by reducing the counter party risk and settlement risk. As the corporate bond market develops and expands, diversifying and expanding investor...
interest will need institutional measures for credit enhancement. We are fortunate in India to have built first-rate credit rating institutions.

**Specialized debt funds for infrastructure financing:** As recommended by the High Level Expert Committee on Corporate Bonds and Securitization, there is a case for creation of specialized Debt Funds to cater to the needs of the infrastructure sector.

**Developing a market for debt securitization:** Apart from reducing the stamp duty on debt assignments, pass through certificates and security receipts, the government should also endeavor to resolve the uncertainty in taxation issues pertaining to securitized paper.

Despite some recent successes, the reform effort in India has not yet reached critical mass. If the authorities can streamline the issuance process and make the public markets attractive to issuers; if they can strengthen the trading platform and settlement and clearing systems; and if they can follow through on plans to allow securitization, then the resulting momentum should help to push through the harder and politicized reforms.

**Further Strengthening of Corporate Governance**

Corporate Governance has been a much debated issue in the western world. In India the Corporate Governance Code has been largely modeled on the lines of the Cadbury Committee (1992) in the United Kingdom. The gaining prominence of Corporate Governance in India has been primarily attributed to the three large scams, the Harshad Mehta scam, the Ketan Mehta scam and the more recent Satyam Computers Limited fraud involving Ramalinga Raju. There have been smaller incidents like the C.R. Bhansali case and the UTI scam, which have further augmented the cause for a strong governance framework.

The World Bank's corporate governance assessment for India has shown that over the last few years, a series of legal and regulatory reforms have transformed the governance framework and significantly improved the level of responsibility and accountability of insiders, board and transparency. A giant step towards the endeavour was the Kumarmangalam Birla Committee Report, which led to the inclusion of Clause 49 in the listing agreement, in the year 2000. The second committee on Corporate Governance was under the Chairmanship of N.R. Narayana Murthy, formed in late 2002. Based on the recommendations of the second committee, SEBI issued a circular in 2003 revising Clause 49 of the listing agreement. The recommendations of the Committee included revisions to the independence of the chairman and proportion of independent directors.

Clause 49 prescribed formation of an audit committee and a shareholder grievance committee with independent directors representing two-thirds of the membership of the audit committee, and with at least one committee member possessing an expert knowledge in the field of finance.
and audit. Clause 49 also enhanced the disclosure requirements, including disclosure of compensation to non-executive directors.

SEBI has introduced the concept of IPO grading, done by a credit rating agency registered with SEBI, for all primary market issuers, who file their draft Red Herring Prospectus, on or after 1 May, 2007. The grading is performed after due consideration to governance structure and financial strength.

The Ministry of Corporate Affairs (MCA) has issued two press releases on January 10, 2010 and January 22, 2010. The latter specify the roadmap recommended by the Core Group set up by the MCA for Convergence of Indian Accounting Standards with IFRS. The highlights of the roadmap include:

Two sets of accounting standards (existing Indian Accounting Standards and Indian accounting standards converged with International Financial Reporting Standards (IFRS)).

- Indian accounting standards converged with IFRS would apply to specified class of companies in three phases.
- Existing Accounting Standards to apply to other companies (including Small and Medium Companies).

Auditor independence

The Naresh Chandra Committee Report incorporated in Clause 49 also regulates the independence of auditors' process. The trend has been that most large companies use international auditing firms to audit their IFRS or US GAAP set of financial statements. However, there are a sizable number of Indian business houses which engage local accounting firms to audit their financial statements. With the inclusion of IFRS in the Indian statutory reporting framework, the auditing profession is likely to undergo a significant unlearning and relearning process to meet the challenges of the high quality financial reporting norms. Independence of Auditor function will go in a long way in furthering the Corporate Governance of Indian Companies.

Conclusion

The Indian capital market has undergone significant change in the last two decades. It has become efficient through use of modern day technology and proactive legislation. It has attracted significant global interest and has managed to establish confidence of both global and local investors.

However, as the economy grows, so does its requirements. Change is a constant and therefore the Indian capital markets also need to continue to evolve to ensure that it meets the challenges of the current day.

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Corporate governance is a key focus area and capital markets needs to ensure introduction of swift legislative changes to ensure confidence in the market. As the global financial crisis begins to recede and normalcy returns in the market, India needs to set forth infrastructure to provide the necessary boost to further the equity and corporate debt market and introduce innovative financial products, to attract more capital / investment inflows into India, while ensuring the best interests of the investors.