**SEMESTER 6th (UG)**

**Subject: BUSINESS ENVIRONMENT**

**UNIT IV CAPITAL MARKET**

**INTRODUCTION**

The capital market is an organised market which comprises sources of long term finance for the industry and government. Indian capital market is one of the largest capital markets in the world. Capital market attracts savings from various sources and makes them available to those sectors of the economy which require funds for productive use. It is generally understood as the market for long term funds and it consists of various individuals and institutions that channelise the demand and supply of long term capital. This is not a market for capital goods rather it is a market for raising and advancing money capital for investment purposes. Like all markets, the capital market is also composed of those who demand funds and those who supply funds.

**The demand for the funds comes from the following :**

(i) Private sector manufacturing industries

(ii) Agricultural sector

(iii) Government, both central and state, need support from the capital market for infrastructural and industrial development of the country.

In a capital market, the supply of funds comes from the individual savers, corporate savings, various banks, insurance companies, specialised financial agencies and also the Government.

The following are some of the institutions supplying funds to the capital market :

(i) Commercial banks are very important investors, which are interested in government securities and to a small extent, debentures of companies.

(ii) Insurance companies like LIC .and GIC are of growing importance, though their major interest is still in government securities.

**CONSTITUENTS OF CAPITAL MARKET**

The rapid expansion of the corporate and public enterprises since 1951 has necessitated the development of the capital market in India. In India, the capital market is broadly divided into two parts

(I) The Gilt Edged Market and

(II) The Industrial Securities Market.

**I. Gilt Edged Market** : The gilt edged market is backed by the RBI for marketing the government and semi-government securities. Since the government cannot default on its payment obligations, the securities are risk free and hence are known as gilt edged, which means, of best quality. In these securities, the returns are guaranteed and there is no scope for speculation and manipulation of the market. As the value of the securities remain stable, these securities are always demanded by banks and other financial institutions.

**II. Industrial Securities** : Market Industrial securities market is a market where securities issued by companies i.e. share, bonds and debentures can be bought and sold freely.

It consists of : A. New Issue Market/Primary market

B. Market for Old Securities/Secondary, Market/the Stock Exchange

**A. Primary Market or New Issues Market:** The new issues market has a primary role to play in mobilising the savings of the industrial investors and the institutional investors. The forms in which these claims are incurred are equity shares, preference shares, debentures, bonds, public deposits, right shares etc. All individuals and the financial institutions in the capital market are part of the new issues market 'There are various methods through which capital can be raised in the new issues market.

**METHOD OF RAISIG CAPITAL IN NEW ISSUES MARKET**

A company can resort to anyone or more of the following methods

**1. Public Subscription or Offer through Prospectus:**  It is very old and common method for the companies to raise capital for meeting the long term requirements through public subscription. It involves inviting subscription from the public through issue of prospectus. on the basis of offer in the prospectus the investors apply for the number of they are willing to take. According to the provisions of the Companies Act, 2013, the company makes the allotment of shares.

The company may offer the abates fur sale as

(i) At the face value of the share In the case of new companies, and

(ii) may be issued at premium or discount in the case of old companies.

A Private company manages necessary funds privately from its members but in case of a public company, public issue of share capital is made. So issue of prospectus is necessary for public company, prospects should contain authentic data and It should he delivered to the Registrar of Company for registration.

**2. Private Placement:**  According to private placement, the company gets the money easily and quickly and need not to worry with the complexities of sale of securities to the public through a prospectus. Under private placement, the financial intermediaries or issuing houses purchases them outright with the purpose of placing with their clients later on. Under private placement, a company can sell its securities privately to one or more financial institutions and brokers. Here, the risk of non-receipt of minimum subscription is avoided. During the time of depression this method of private placement is very effective. Under this method, brokers will earn profit in the process of reselling to the public.

**3. Offer of Sale:**  Under this method of raising finance, a major portion of the shares of a new company is sold to the promoters or its holding company or through intermediaries such as issuing houses or ` sharebrokers. Here, the company sells shares at an agreed value to sharebrokers who intum resells them to the investing public. The big shareholders (foreign financial institutions) sell their shares also to the general public through an 'offer for sale' contained in a prospectus. The main advantage of 'offer for sale' is that it saves the company from the cost and difficulty of selling securities to the investing public directly and the main disadvantage of 'offer for sale' is that the entire premium received by selling these shares is retained by those big shareholders and not by the company.

**B. Secondary Market or Market for Old Issues**

Secondary market is the market for sale and purchase of previously issued or second hand securities. In other words, in secondary market, already allotted shares/debentures/units are purchased and sold in different hands and transactions take place in different stock exchanges of India. Secondary market provides liquidity to investment and enhance the marketability of securities but it does not directly contribute to capital formation. A security takes birth in primary market but its subsequent movements takes place in secondary market. Secondary market has become very popular these days because of development of capital market and special financial institutions.

**FACTORS CONTRIBUTING TO THE GROWTH OF CAPITAL MARKET IN INDIA**

The following are the factors that have contributed to the tremendous growth of capital market in India :

**1. Growth of Financial Intermediaries :** Growth of financial intermediaries like UC, UTI, GIC, IDBI, ICICI has contributed significantly in widening and strengthening capital market in India. These institutions have enhanced the flow of funds from domestic savers to users in the capital market.

**2. Setting up of SEBI :** The government of India established the Securities and Exchange Board of India (SEBI) on April 1992 to control and direct the development of securities market. Since then, the SEBI has been taking measures to infuse transparency in the capital market. SEBI regulates the working of stock exchange, brokers, mutual funds, merchant bankers to protect the interest of investors.

**3. Growth in Unwriting Business :** The growing underwriting business has also led to the growth of capital market. Earlier the function of underwriting was mainly performed by the stock brokers and banks and the volume of securities underwritten was very low. At present, the volume and amount of securities underwritten have increased tremendously due to participation of specialized financial institutions like LIC, UTI, IDBI, IFCI, ICICI etc.

**4. Growth in Response of Public Issues :** Growing response to public issues of shares and bonds has strengthened the Indian capital market. Before 1951, the industrial securities were not popular in India as form of investment. Indian investors being risk-averters had been reluctant to invest in share market. However, since 1991 public response to corporate securities has improved considerably.

**5. Growth of Merchant Banking :** The growth of merchant banking has strengthened the base of Indian capital market. The merchant banking division of banks advises the companies about economic, financial and technical feasibility of project. They act as underwriter as well as the manager of new issue of securities.

**6. Growth of Crdit Rating Agencies :** The emergence of credit rating agencies like CRISIL, ICRA and CARE etc. in the financial sectors has given boost to Indian capital market. Credit rating agencies rate the credit instruments issued by the corporate firms such as bonds, debentures, preference share, corporate bonds etc. Credit assessment done by these agencies enhances the confidence of investors to invest in the share market. It also helps the companies to raise funds more easily and at cheaper rate if their credit rating is high.

**7. Growth of Mutual Fund Companies :** Mutual fund companies mobilise the savings of relatively small investors and invest in primary and secondary market in diversified manner. Thus the growth of mutual fund companies in India has contributed to the growth of capital market.

**8. Growth of Stock Exchanges in India :** The origin of capital market in India started from 1875 by the establishment of Bombay Stock Exchange (BSE). National Stock Exchange (NSE) was established in Mumbai in 1992. Both BSE and NSE are leading stock exchange of India working at national level. Beside these two, other stock exchanges are Calcutta Stock Exchange, India INX, MSE and NSE IFSC Ltd. The development of stock exchanges has facilitated the listing and trading of securities.

**9. Growth of MNC's :** The MNC's require medium and long term funds for setting up new projects or for modernisation and expansion. For this purpose, they raise funds from banks and financial institutions. Due to presence of MNCs, the capital market get a boost.

**10. Liberalisation Measures :** The liberalisation measures taken by the government of India under new economic policy gave a further boost to the growth of Indian capital market. Access to Indian Capital Market to Foreign Institution Investors and Liberalised investment norms for NIRI's have contributed to the growth of Indian Capital Market.

**11. Increasing Awareness :** Business newspapers and journals like The Economic Times, The Financial Express, Business India etc. and T.V. Channels like Zee Business, CNBC Awaaz etc. have made public more aware regarding investment opportunities in the security market.

**12. Increased Investor Confidence :** Due to existence of various rules and regulations exercised by SERI, the investors confidence in the share market has increased which in turn led to the growth of capital market.

**ROLE OF CAPITAL MARKET IN INDIA'S GROWTH**

Capital markets play a very important role in the growth of a country. Capital markets have played the following role in India's industrial growth :

**1. Financing of Five Year Plans:** In many developing countries, government securities have become an important part of the capital market for the purpose of providing funds for carrying out plans. In India, ever since the beginning of the Second Five Year Plan, the government securities have continuously gained in importance as the government not, depend on this measure to raise resources for financing public sector projects. In many years, the government was able to appropriate for itself as much as 50% of the savings of the household sector in the form of financial assets through the device of Treasury and market loans sold to banks and other institutions Bills

**2. Savings and Capital Formation:** Capital market play an important role in the mobilisation of savings and acceleration of capital formation. A country like India, plagued by paucity of resources and increasing demand for investments by industrial organizations and governments, the importance of the capital market is self evident. Capital markets give twin incentives to people in the form of reasonable return and liquidity. This accelerates the capital formation in the country.

**3. Industrial Growth**: Capital markets stimulate industrial growth and economic development of the country by mobilising funds for investment in the corporate securities. Capital market encourages people to invest in productive channels rather than in the unproductive sectors like real estate, bullion etc.

**4. Long Term Capital:** The existence of a well established capital market enables companies to raise permanent and long term capital. The investors cannot commit their funds for a permanent period but companies require funds permanently. The capital market resolves this clash of interests by offering an opportunity to investors to buy or sell their securities while permanent capital with the company remains unaffected.

**5. Ready and Continuous Market:** The capital market provides a central convenient place where buyers and sellers can easily purchase and sell securities. The element of easy marketability makes investment in securities more liquid as compared to other assets.

**6. Proper Channelisation of Funds:** An efficient capital market creates liquidity through its pricing mechanism and it also allocates resources to the most efficient industries. The guiding factors for the people to channelise their funds in a company are prevailing market price of the security and relative yield capital market ensures effective utilisation of funds in the public interest.

**7. Provision of Services:** The financial institutions functioning in the capital market provide a variety of services eg.

(i) Grant of long and medium term loans to entrepreneurs to enable them to establish, expand or modenise business units

(ii) Provision of underwriting facilities

(iii) Participation in equity capital

(iv) Expert advice on management of investment in industrial securities

(v) Assistance in the promotion of companies through Development Banks, like the IDBI.

**DIFFERENCE BETWEEN MONEY MARKET AND CAPITAL MARKET**

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| 1. Money market is a market for short term loans where the period of borrowing and landing is less than one year. | 1. Capital market is a market for long term Jeans where the period of borrowing and lending is over one year. |
| 2. Money market consists of a number of interrelated 'sub-markets, such as call market, treasury bill market, commercial bill market, loan market etc. | 2. Capital market consists of primary market mil secondary market. |
| 3. Money market is a wholesale market. | 3. Capital market is both a wholesale and retail market. |
| 4. The finance provided by money market is utilized mainly for working capital. | 4. The finance provided by capital market may be used for fixed and working capital. |
| 5. There are large sized participants in money market such as RBI, Commercial Banks, LIC etc. | 5. In capital market, participants are both large as well as small individual investors. |
| 6. It provides short term funds to government by purchasing treasury bills and to others by discounting bills of exchange etc. | 6. It provides long term fund to central and state governments, public and local bodies for development purposes. |
| 7. Money market is basically over the phone market. | 7. Capital market transactions may be on phone, stock exchanges the office of intermediaries etc. |
| 8. The instruments, of money market are safe or less risky due to short duration and soundness of issuers. | 8. The instruments of capital market are riskier in respect of returns as well as in respect of principal repayment as issuing company may fail. |