

Outlook

4.51 India embarked on dramatic reforms on the equity market in the early 1990s, with a quest for a new market design which was transparent, harnessed the whole country, while having competition between multiple exchange institutions and having no entry barriers in financial intermediation. This quest was substantially completed with the shift to rolling settlement in 2001. With these sound foundations, the equity market has worked very well in the period after 2001, with continual growth of market size, greater sophistication of trading strategies, and steady growth in participation by households. The far-reaching reforms from 1993 to 2001 are ultimately responsible for the accomplishment highlighted in Table 4.3, where India figures prominently in the list of the biggest exchanges in the world, measured by the number of transactions.

4.52 SEBI has embarked upon new efforts on the primary market, in response to the difficulties seen with the bunching of public issues in 2004. The equity market now has fairly well functioning components on the entire 'food chain', comprising pre-IPO (venture funds, private equity funds), the IPO market (electronic auctions), secondary market (nationwide electronic trading), market participants (households, mutual funds, insurance companies, FIs), the market for corporate control (M&A market), and the indexation industry (stock market indexes, index funds, index derivatives). All aspects of this ecosystem come together in delivering the observed liquidity and market efficiency.

4.53 In coming months, considerable investment appears to be in the pipeline, reflecting confidence by domestic and foreign investors in the economic outlook. The securities markets are well equipped to engage in information processing and intermediation, and support the investment activities of 2005-06.

4.54 The securities markets have been a fertile ground for fostering modern regulatory structures. SEBI was a new organisation created in the early 1990s. SEBI has been a pure regulator, and has maintained a separation between regulation and service provision. All markets that SEBI regulates have competitive conditions. The legal architecture underlying SEBI and the equity market has been sound. These factors have enabled the success of the equity market.

4.55 A strategy has to be chalked out for the development of the bond market. India is an ideal environment for a liquid bond market, given large public debt issuance, and sophisticated exchange institutions. The bond market has made one important step forward, in the form of the Clearing Corporation of India (CCIL), whereby there is no post-trade settlement risk. The bond market has yet to find the policy framework through which the success of the equity market can be emulated. A striking manifestation of the weaknesses of the design of the bond market has been observed in the recent period, in the form of a significant dropoff of turnover, even though the market size has been steadily growing through large scale public debt issuance.