REVIEW OF RESEARCH

IMPACT FACTOR : 5.7631(UIF) UGC APPROVED JOURNAL NO. 48514 ISSN: 2249-894X

VOLUME - 8 | ISSUE - 5 | FEBRUARY - 2019

# PERFORMANCE OF INDIAN STOCK MARKET AFTER LPG

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**ABSTRACT :**

*This study aims to investigate whether the stock market performance leads to economic growth or vice versa; study also examines short-run and long-run dynamics of the stock market. We use of monthly Index of Industrial Production (IIP) and quarterly Gross Domestic Production (GDP) data for the time span of April, 1996 to March, 2009. This provides rich data for the empirical analysis. We undertake; Unit root (ADF, PP and KPSS) tests, Granger Causality test, Engle-Granger Cointegration test and Error Correction Model. The monthly results of Granger causality test suggest that there is a bidirectional relationship between IIP and Stock prices (BSE and NSE) and quarterly results reveal that there is no relationship between GDP and BSE but in the case of NSE and GDP there is a unidirectional relationship and that runs from GDP to NSE.*

**KEYWORDS :** *economic growth , Gross Domestic Production (GDP) .*

## INTRODUCTION

Logic simply doesn't work here. The pundits had all but signed it off, condemning the stock-markets to the dead zone in 1991, citing economic crisis as the reason. But figures have never told a more positive story.

The rise began last January, when the Bombay Stock Exchange (BSE) Sensitive Index went on climbing through the Gulf War, the balance of payments problem, the delay in the budget and Rajiv Gandhi's assassination. The markets conceded a few points for the rupee devaluation, but zoomed up after the budget presentation in July, and didn't look back.

The blips in the pattern were merely administrative crises in various exchanges, and wrangling among brokers. Nobody was looking ahead at 1992, when the economic crunch will begin to be felt. "It was a bit of a party," says a Bombay-based financial consultant.

It was - the BSE index's average value took off at 996.45 in January to close the year at 1,908.8 with a late surge thrown in on the last day of trading on December 24. Despite mutual funds - the traditional shock absorbers - staying away, the markets were fairly bullish.

The best ever year at the markets, with average daily trading volumes at the BSE - which accounts for close to 70 per cent of Indian share bazaar dealing - at Rs 240 crore.Up from Rs 188 crore in 1990 and Rs 127 crore the year before.

The talks of the economy heading for a slowdown have apparently been discounted by the traders who expect some reliefs from the Government during 1992. Traders also want the RBI to ease money supply by the middle of January.

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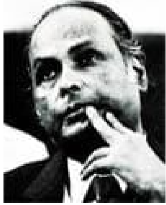

**DHIRUBHAI: NEEDS HIS OLD MAGIC**

The money markets have already turned easy. There is also expectation that the Government will pull back import curbs, with foreign exchange reserves comfortable.

Also, speculation about a total decontrol on steel prices led to a sharp surge in the prices of steel shares. TISCO, the market leader, shot up to a high of Rs 252.50 - the scrip has jumped nearly 120 points over the past year. Recent media reports about the discontent in the top echelons were ignored by the market.

Pharmaceutical shares were also upbeat through the year, and even more so recently on expectations of an announcement of the longawaited Drug Price Control Order - Hindustan Ciba, Hoechst, Wyeth Labs. E. Merck, among others, notched up significant gains in the last fortnight.

Currently, despite the holiday mood - markets were closed from December 25 to 31 - eyes are pegged on the future of the Rs 858-crore Reliance Industries Limited's (RIL) rights debenture issue that hit the stands last fortnight. Although it's open only to shareholders, there is interest in this issue as the future of the delayed gas cracker plant at Hazira depends on these funds.

While the market is a little apprehensive, RIL officials say an early sluggishness isn't worrisome as most rights issue funds are collected only in the last five days. "Since 1979, we've gone to the market 11 times," says RIL Executive Director Anil Ambani. "Every time, the response was overwhelming."

It is crucial the issue succeeds for another reason: in the public mind, RIL chairman DhirubhaiAmbani's go-getting image has taken a beating with problems to reaquire L&T. Pulling in money may help clean this up.

Upbeat mood or not, the fact is that the economy is in a tailspin, with sixmonthly corporate reports and a forecast of modest results in 1991-92 being absorbed by the stock-markets. The growth rate of industrial production and manufacturing have gone below zero. Some segments such as automobiles and computers are already plagued by a recession, and consumer durables could follow.

If the Government manages to spend less, the effect will spread across the board. Says Sunil Jhaveri, a Bombay stockbroker: "The market has already discounted the good news." If that's the truth, then 1991 - when the bad news was discounted - will seem like a dream

The equity market in the 1990s

The equity market was prominent in the public imagination in the early 1990s owing to thefamous "stock market scam" of 1992. This was a somewhat unfair characterisation, insofar asthe malpractices on the GOI bond market were atleast as important as those on the stock market.

However, this helped generate interest on the part of policy makers in new designs of the equitymarket.The problems of the BSE as of 1992 have been extensively documented elsewhere (Shah 1999,Shah&Sivakumar 2000). Over the decade of the 1990s, a series of profound changes to themarket design took place:

•Electronic trading (1994).
All exchanges in India switched from floor trading to anonymous electronic trading.
•Risk containment at the clearing corporation(1996).
The largest exchange, NSE, adopted riskmanagement through "novation" at the clearing corporation. Other exchanges also substantiallyimproved their risk containment mechanisms.
•Dematerialisation(1996).
Almost all equity settlement today takes place at the depository.

•Derivatives trading(2000, 2001).
In 2000 and 2001, equity derivatives trading commenced, withindex derivatives and derivatives on some individual stocks.
•Elimination of leveraged trading on the spot market(2001).

"Futures style settlement" and deferralmechanisms, which implied that the spot market featured leverage and futures–market principles,were banned in favors of rolling settlement.These changes add up to a complete transformation of the market design of the equity market.A less noticed aspect of these changes is the remarkable extent of new human capital whichwas created to operate this new securities market infrastructure.

Very few observers in 1991could have predicted that traditional investors and stock brokers would be trading on computers,giving instructions for transfer on the depository over the Internet, and trading in index futuresand options. The transition from physical share certificates to depository settlement involved aloss of thousands of jobs. That this process took place without friction is testimony to the labourmarket flexibility in the securities industry. Over the decade of the 1990s, atleast a hundredsignificant brokerage firms have gone bankrupt. That this exit has taken place without friction istestimony to the lack of rigidities in the securities industry.

There were many difficult political battles and practical hurdles in these years, and it is possible tomake the case that these changes could have been completed several years before 2001. However,now that these changes are behind us, the process of transforming the market design on the equitymarket is largely complete.

At the same time, the decade of the 1990s was marred by a steady procession of stock marketcrises. These crises made the front pages of newspapers, and have played an important role inconveying an image of disarray and fraud when uninformed households in India think about thestock market. A central feature of these crises was the incidence of market manipulation onthe secondary market. In understanding policy issues connected with securities markets, it isimportant to better understand these episodes, and learn from them.

### 1992: Harshad Mehta

.The first "stock market scam" was one which involved both the GOI bondand equity markets in India. The manipulation was based on the inefficiencies in the settlementsystems in GOI bond market transactions. A pricing bubble came about in the equity markets,where the market index went up by 143% between September 1991 and April 1992. The amountinvolved in this crisis was approximately Rs.54 billion.

### 1994: M. S. Shoes

Here the dominant shareholder of the firm, PawanSachdeva, took large lever-aged positions through brokers at both the Delhi and Bombay stock exchanges, to manipulate shareprices prior to a rights issue. When the share prices crashed, the broker defaulted and BSE shutdown for three days as a consequence. The amount involved in the default was Rs. 170 million.

### 1995: Sesa Goa

. Another episode of market crisis for the BSE, was the case of price manipulationof the shares ofSesa Goa. This was caused by two brokers, who later failed on their marginpayments on leveraged positions in the shares. The exposure was around Rs. 45 million.

### 1995: RupangiImpex and Magan Industries Ltd.

The prices ofRupangiImpex Ltd.(RIL) wasmanipulated in October 1995 andMagan Industries Ltd.(MIL) in January 1996. In both cases,the dominant shareholders implemented a short–squeeze. In both cases, the dominant shareholderswere found to be guilty of price manipulation. The amounts involved were Rs.5.8 million in thecase of MIL at the BSE, and Rs.11 million the case of RIL at the NSE.

## 1995: Bad deliveries of physical certificates

When anonymous trading and nation-wide settlementbecame the norm by the end of 1995, there was an increasing incidence of fraudulent shares being delivered into the market. It has been estimated that theexpectedcost of encountering fakecertificates in equity settlement in India at the time was as high as 1% (Shah & Thomas 1997). C. R. Bhansali created a group of companies, called the CRB group, which was aconglomerate of finance and non-finance companies. Market manipulation was an important focusof the activities of the group. The non–finance companies routed funds to the finance companiesto manipulate prices. The finance companies would source funds from external sources, usingmanipulated performance numbers. The CRB episode was particularly important in the way itexposed extreme failures of supervision on the part of RBI and SEBI. The amount involved in the CRB episode was Rs.7 billion.

## 1998: BPL, Videocon and Sterlite

This is an episode of market manipulation involving the brokerthat engineered the stock market bubble of 1992, Harshad Mehta. He seems to have worked onmanipulating the share prices of these three companies, in collusion with the management of thecompanies. The episode came to an end when the market crashed due to a major fall in the index,and Mehta did not find the liquidity to maintain his leveraged positions. In this episode, the topmanagement of the BSE resorted to tampering with records in the trading system in trying to averta payments crisis. The President, Executive Director, and Vice President of the BSE had to resigndue to this episode. This episode also highlighted the failure of supervision on the part of SEBI.The amount involved in this episode was Rs.0.77 billion.

## 2001: Ketan Parekh

Our knowledge of the modus operandi of this episode is the weakest, sinceinvestigations are still under way. This was triggered off by a fall in the prices of IT stocks globally.Ketan Parekh was seen to be the leader of this episode, with leveraged positions on a set of stockscalled the “K10 stocks”. There are allegations of fraud in this crisis with respect to an illegalbadlamarket at the Calcutta Stock Exchange and banking fraud.

This procession of crises has cast a shadow over the credibility of SEBI, and its capacity toproduce a safe and sound equity market. To the extent that the appropriate response lay ineliminating leveraged trading and moving to rolling settlement, these crises highlight the costs tothe economy of SEBI’s efforts from 1995 onwards in adopting a conservative position, i.e. thatof perpetuating weekly settlement andbadlaThese episodes of market misconduct have been extremely disruptive of the core functions of theequity market, i.e. (a) pricing efficiency, and (b) intermediation between households investing inshares and firms financing projects by issuing shares.

## TURNING TO THE REFORMS, THREE MAJOR REFORMS TOOK PLACE IN THE EARLY 1990S:

Improvements to SGLThe RBI moved to computerise the SGL and implement a form of a‘delivery versus payment’ system.Enforcement of a “trade for trade” regimeThe RBI setup a strong regulatory system whichrequired that every trade must settle with funds and bonds; IOUs and all forms of nettingwere prohibited.

## Trade reporting at NSE

A limited degree of transparency came about through the WholesaleDebt Market (WDM) at NSE, where roughly half the trading volume of India’s GOI bondmarket is reported. WDM is not a market in the sense that it does not possess liquiditywhich can be used to match orders. Yet, it marks a step forward insofar as it reveals usefuldata about prices and traded quantities.

These reforms served to close the windows through which the pervasive failures of clearing andsettlement generated the Scam of 1992. Today, SGL works much more effectively as comparedwith 1992. IOUs and uncontrolled leverage are completely absent. In this sense, one objective,of preventing the

recurrence of the Scam of 1992, has clearly been met.However, these reforms did not address the core problems of the debt market, the reliance ondistributed dealers interacting by telephone in Bombay. This problem, and the "trade for trade"regime, which forbids all forms of netting, are the hurdles now faced in obtaining market liquidity.

In summary, when we compare the GOI bond market in 2001 as compared with that seen adecade ago, there are two major changes: The chaotic world of bilateral netting was replaced by a trade-for-trade regime with settlement at afairly efficient depository.

## Why did NSE succeed?

A finance–oriented treatment of this question can be found in Shah &Thomas (2000). In our treatment here, we focus on the public policy, and governance, aspects ofthe NSE experience. Some of these were unique to the setting where NSE came in. Others aredesign features which can sometimes be consciously adopted in other attempts at the creation ofinstitutions in the public sector.

•Opportunity to bring in a paradigm shift in technology

NSE was able to exploit the situationwhere BSE had done extremely little in terms of using computer technology. NSE harnessed newtechnology to produce a paradigm shift in market design. If BSE had built the most minimal marketinfrastructure – e.g. using a design like RBI's NDS – it is unlikely that NSE would have made theprogress that it made.

•Legal engineering to keep a distance from government

The ownership structure of NSE was care-fully constructed so that it did not suffer from the operational rigidities of public sector firms whichare directly owned by the government.

•Private sector HR policies

NSE adopted private sector wages and HR policies. This helped produce greater accountability and growth of human capital.

•Incentive compatibility for owners

Shareholders of NSE such as IDBI, UTI, etc.were users ofsecurities markets, and stood to gain from a more liquid stock market, even if that hurt the interestsof stock brokers.

## CONCLUSION

Human capital and governance at SEBI and RBI. The decade of the 1990s has been marred byimportant failures of governance at SEBI and RBI. In the case of RBI, it is possible to focus thelimited regulatory capacity on a smaller set of issues by emulating SEBI: by putting the functionsof operating the technology-intensive securities market infrastructure outside RBI. In the case ofboth RBI and SEBI, there is a need for major improvements in the human capital, governancestructure and regulatory capacity of the organisation.

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