Analysis of Changes in Investment Trends and Patterns in Indian Capital Markets: A comparative case study of NSE for Pre and Post Crisis period

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ABSTRACT

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Capital markets are widely considered as an indicator of an economy. These markets act as windows to economy; activities in the markets are the reflection of activities in an economy. Recently, Indian Capital Market along with global capital markets has experienced its most volatile phase so far. The economic condition in India is also unstable and is facing considerable instability in its key economic indicators such as economic growth is decelerating quarter after quarter, inflation is much beyond the comfortable trajectory and interest rate hovering in the higher trajectory. In addition to this, capital market has also been caught up with the global uncertainties and have placed unstable environment for the investors. Understanding the markets composition and its behavior is therefore, important for the investors, who wish to maximize their returns through investments in the stock markets. This study seeks to analyze the investment trends and patterns in Indian Capital Markets in the pre and post crisis period with special reference to National Stock Exchange. To meet the objectives; secondary data from the website of NSE and annual reports of SEBI and RBI is procured and classified into Pre-crisis (2004-05 to 2007-2008) and Post Crisis (2008-09 to 2011-12). Changes in trends and patterns are identified, analyzed and reasons for such changes and their possible effects on the economy are focused.

Keywords
Trends and Patterns in Indian Capital Markets, Composition of NSE pre and post crisis, intra derivatives switch in investments

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1 Research Scholar
1. Introduction

In 1990’s masses were oblivious of shares and stock markets in India. But with the innovative developments such as the initiation of trading at NSE in 1993-94 and establishment of SEBI along with the introduction of online trading system has changed the perception and attitude of investors towards capital market to a great extent. However, Indian capital market experienced the major change when index futures were introduced in June 2000, after SEBI granted the final approval to this effect on the recommendation of L. C Gupta committee. Further, trading in index options was permitted in June 2001 followed by the stock options in July 2001, stock future in November 2002, currency futures in August 2008, interest rates future in August 2009 and currency options in October 2010. The gradual opening up of capital markets for the derivatives products not only has a significant impact on volumes but also on the investment pattern in the financial markets. Derivatives with their leveraging potential contributed to the popularity of the financial markets. On one hand, they gain popularity as the hedging tools on the other hand with high risk-return profile these are widely popular as tools for making quick gains, among the speculators and traders.

Financial markets worldwide were experiencing their golden period, riding the boom phase of the global economy and gradually rising to touch the new heights leaving behind most of the previous peaks before the effects of over-heating were felt with the collapse of Bears Stern and Lehman Brothers the big investment banks. The long standing bullish trends suddenly turned to long lasting bearish trends. Index touched their lowest values and GDP of many major economies changed the quadrants as fear of uncertainty and suspicion prevailed. The high bail out packages by global institutions and the governments of respective countries were offered to save many business entities and banks which were trapped in the debt crisis, leading to worsening of fiscal deficits in many countries. However, the crisis seems triggered by the mortgage crisis and over-heating of the asset prices, bubble in the financial markets also played a major role in channelizing and spreading its impact to all the major global economies. High leverage character and complex nature of the derivatives has its own role somewhere at micro and somewhere at macro level to wide spread the effects of the crisis.

The world economic environment is currently volatile, which has a potential of disruptive consequences for all economies around the globe. The economic situation in India is also unstable at this stage and is facing considerable instability in its key economic indicators such as economic growth which is decelerating quarter after quarter; inflation is much beyond the comfortable trajectory and interest rate hovering in the higher trajectory. In addition to this, capital market has also been caught up with the global uncertainties and have placed unstable environment for the investors. On the other hand, gold has put forth better investment opportunities for investors throughout the previous year, 2011. However, easing interest rates, surging capital inflows and the recent stand of the government for reforms without fear shall expectedly have the positive effects on the overall growth of India. Besides, market indices are also operating in the comfortable zone. Therefore, it is expected that Indian economy will experience the higher and more stable growth if global scenario remains normal.

2. Objectives of the study

The main objectives of the present study are as follows:

- To study and analyze the trends in the major market segments of NSE
- To examine the flow of inter market investment in different segments of NSE.
- To carry out a comparative analysis of investment trends in the capital markets for the Pre and Post Crisis period.
- To review changes in the composition of derivative segments and capture the causes for the same
- Graphical Presentation of the overall changes in trends and patterns post financial crisis in the various segments of NSE.

3. Methodology

The present study is largely based on the secondary data obtained from the website of NSE (www.nseindia.com) and the annual reports of SEBI and RBI since 2004-05. The year for comparative analysis has been divided into Pre and the Post crisis from 2004-05 to 2007-08 and from 2008-09 to
2011-12 respectively. The tabulated data is compiled in the excel format from which the most relevant graphs are drawn to give clear pictures of the trends in the stock markets. On the basis of the trends in the data the analysis for it has been done and the reasons for change in the composition and pattern in the markets are discussed.

3.1 Trends in the Segments of NSE

NSE India is at present operating in the cash market, Equity F&O, Currency F&O, Interest rates F&O, and Wholesale Debt Market along with separate platform for commodity trading. The composition of NSE has shown changes in structure not only due to the crisis but also because of horizontal and vertical expansion.

If we study the overall trend in the segments of capital markets it is easy to conclude that F&O segments rule the markets in terms of value of trades and turnover. Figure 1 indicates that the F&O segments of equity and currency supercede the trading volume of the cash market turnover due to their high leveraging nature and involvement of high corpus funds in their hunt to outperform the markets.

3.2 Cash Market Segment

The Cash Market Segment has shown rising trends till the Year 2007-08, experienced a sharp decline from Rs.35, 51,038 Crore in 2007-08 to Rs.27, 52,023 Crore, registering a loss of about 22.5% in the market capitalization. However, it recovered to Rs.41, 38,024 Crore in the following year but couldn’t sustain it and re-declined to Rs. 2,81,0893 Crore due to slowing growth specifically weak industrial growth, high inflation, euro-zone troubles and other global uncertainties.

F&O Segment of the equity market not only sustain it highest value segment but also keep it growth rate high and continuous except the year 2008-09 when it declined by around 16 per cent. The value of turnover which stood at Rs. 25, 46,982 Crore in 2004 crossed Rs. 100,000 crore marks by the end of the year 2011-12.

3.3 Wholesale Debt Market (WDM)

Though it has comparatively insignificant share but trends in it indicated the fluctuation in risk-return behavior of the investors’ pre and post crisis. With the crisis at the door, funds flow towards debt market from the equity market increases and with the recovery, funds are re-diverted from the equity market to the debt market. As the growth rate was rising, debt market was declining but when equity market crashed WDM market gained this can be confirmed by the following table 1 compiled from the fact book of NSE.

Table 1 indicates heavy diversion of funds from low yield debt markets to the capital market which were booming before the influence of the crisis felt and then reversal of funds to the equity market when recovery starts.

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3.4 Currency F&O Segment
The growth of this segment is also remarkable despite of its late introduction in second half of the 2008. It registered a growth of about 2781% from just Rs.1,62,272 Crores in 2008 to Rs. 46,74,990 Crores and overtook the cash market in terms of value of turnover by the end of the year 2011-12.

3.5 Interest rates F&O Segment
It was initiated in the 2009 failed to get adequate attention due to less developed markets for interest rates and its trade value remain insignificant at as low as Rs. 3959 Crores despite 3 years of trade.

3.6 Equity F&O Segment
The equity market not only sustain its highest value segment but also keep it growth rate high and continuous except the year 2008-09 when it declined by around 16%. The value of turnover which stood at Rs. 25,46,982 Crores in 2004 crossed Rs. 3 crore marks by the end of the year 2011-12.

In the F&O Segment of NSE, trends reveal that the impact of the crisis on the investment behavior of investors was tremendous. Whereas, the investments were high return oriented despite of high risk profile in the pre-crisis period (2004-08) these starts shifting towards comparatively safer index options in the post crisis years (2009-12). Stock Futures with their high risk-return profile were on the priority of investors before the crisis which shows that the investors were more concerned about the returns then the risk in the pre crisis period. However, in the post-crisis period, Index options indicate a robust growth at the cost of decline in the stock and the index futures, indicating shift to the safer derivatives trades.

Table 1: Wholesale Debt Market (WDM)

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<td>% Growth over previous year.</td>
<td>-46.41</td>
<td>-53.92</td>
<td>28.85</td>
<td>19.00</td>
<td>67.83</td>
<td>-0.77</td>
<td>13.18</td>
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Source: compiled through the fact book of NSE

Figure 2: Ratio of Market Segment to GDP

In the F&O Segment of NSE, trends reveal that the impact of the crisis on the investment behavior of investors was tremendous. Whereas, the investments were high return oriented despite of high risk profile in the pre-crisis period (2004-08) these starts shifting towards comparatively safer index options in the post crisis years (2009-12). Stock Futures with their high risk-return profile were on the priority of investors before the crisis which shows that the investors were more concerned about the returns then the risk in the pre crisis period. However, in the post-crisis period, Index options indicate a robust growth at the cost of decline in the stock and the index futures, indicating shift to the safer derivatives trades.
This gradual shift in the investment pattern of F&O Segment depicted in the Figure 3 suggests that the index futures that constitute around 30% of the total trades of F&O Segment in the pre-crisis period decline to meager 11.4% by the end of the year 2011-12, whereas, stock future that possess the lion’s share of more than 50% in the pre-crisis period revealed a steeper and gradual decline to just 13% at the end of 2011-12. Index options, the share of which was continuously low nearing 10%; shows continuous and high accelerating growth to 72.47% in 2011-12.

**Figure 3: Trends of F&O Segment of NSE**

**Figure 4: Turn Over of different market segments**
The percentage share of different market segments at the end of June 2012 is shown in Figure 4. The share of Equity F&O Segment is clearly seen as most significant with 80% of the total turnover at NSE, followed by the recently introduced currency F&O Segment. The share of the cash market now contributes just 6% in the total value of turnover in the capital markets. The relevance of F&O segment has risen despite of derivatives roles in triggering the crisis though the inter derivatives composition has changed a lot with a remarkable shift towards the safer index options then the futures with high risk possibility.

**Conclusion**

Indian stock markets have experienced an unprecedented and unjustified boom before the crisis has restructured themselves with the reduced risk tolerance among the investors. Our markets indices has crossed 21,500 mark with its average P/E rising above 30 times before their growth was compelled to take the U turn as the effects of the crisis has shaken the market with the beginning of the year 2008.

Indian economy that has been enjoying high growth of 9% shivered by the waves of fear an uncertainty imported from the global markets.

Some positive developments noticed during the crisis phase were that Domestic Institutional Investors (DIIs) and mutual funds tried to counter the demand side pressure with their buying spree in the declining markets thereby, making domestic indices at least to some extent less prone to FII triggered volatility. Consequently, Sensex and Nifty got the fundamental support around 12,000 and 4000 respectively after touching their year's low. The recovery after the crisis was supported by the domestic factors making the rebound in indices fundamentally strong.

Indian markets before the crisis were no doubt overheated, being overvalued due to heavy short-term funds investments. There was a need for correction and triggering of the crisis caused that. Overvaluation was shed and market though remained under-valued for some period it re-jumped to its desired level when the UPA returned to power with majority.

Current composition of the market reveals that now the investors are aware of any crisis and are cautiously choosing their investment avenues, that is why many popular company’s shares that has touched the unexpected high never regain even 2/3rd of their pre-crisis high. The present composition is therefore; fundamentally better than the unjustified overpricing though it has slowed down the growth of the capital markets. Eventually, despite of all adversities crisis taught us how to sail our economy to the growth when tides turn opposite and there is an exigency to reduce the dependency on unstable short term capital inflows.

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