Indian capital market

Countries

The Indian capital market has changed dramatically over the last few years, especially since 1990. Changes have also been taking place in government regulations andtechnology. The expectations of the investors are also changing. The only inherent feature of the capital market, which has not changed is the 'risk' involved in investing incorporate securities. Managing the risk is emerging as an important function of both large scale and small-scale investors. Grewal S. S and Navjot Grewall (1984) revealed some basic investment rules and rules for selling shares.

They warned the investors not to buy unlisted shares, as Stock Exchanges do not permit trading in unlisted shares. Another rule that they specify is not to buy inactive shares, ie, shares in which transactions take place rarely. Themain reason why shares are inactive is because there are no buyers forthem. They are mostly shares of companies, which are not doing well. A third rule according to them is not to buy shares in closely-held companies because these shares tend to be less active than those of widely held ones since they have a fewer number of shareholders.

They caution not to hold the shares for a long period, expecting a high price, but to sell whenever one earns a reasonable reward. Jack Clark Francis (1986) revealed the importance of the rate of return in investments and reviewed the possibility of default and bankruptcy risk. He opined that in an uncertain world, investors cannot predict exactly what rate of return an investment will yield. However he suggested that the investors can formulate a probability distribution of the possible rates of return.

He also opined that an investor who purchases corporate securities must face the possibility of default and bankruptcy by the issuer. Financial

analysts can foresee bankruptcy. He disclosed some easily observable warnings of a firm'sfailure, which could be noticed by the investors to avoid such a risk. Preethi Singh3(1986) disclosed the basic rules for selecting the company to invest in. She opined that understanding and measuring return m d risk is fundamental to the investment process. According to her, most investors are 'risk averse'.

To have a higher return theinvestor has to face greater risks. She concludes that risk is fundamental to the process of investment. Every investor should have an understanding of the various pitfalls of investments. The investor should carefully analyse the financial statements with special reference to solvency, profitability, EPS, and efficiency of the company. David. L. Scott and William Edward4 (1990) reviewed the important risks of owning common stocks and the ways to minimise these risks. They commented that the severity of financial risk depends on how heavily a business relies on debt.

Financial risk is relatively easy to minimise if an investor sticks to the common stocks of companies that employ small amounts of debt. They suggested that a relatively easy way to ensure some degree of liquidity is to restrict investment in stocks having a history of adequate trading volume. Investors concerned about business risk can reduce it by selecting common stocks of firms that are diversified in several unrelated industries. Lewis Mandells (1992) reviewed the nature of market risk, which according to him is very much 'global'.

He revealed that certain risks that are so global that they affect the entire investment market. Even the stocks and bonds of the well-managed companies face market risk. He concluded that market risk is influenced by

factors that cannot be predicted accurately like economic conditions, political events, mass psychological factors, etc. Market risk is the systemic risk that affects all securities simultaneously and it cannot be reduced through diversification Nabhi Kumar Jain (1992) specified certain tips for buyingshares for holding and also for selling shares.

He advised the investors to buy shares of a growing company of a growing industry. Buy shares by diversifying in a number of growth companies operating in a different but equally fast growing sector of the economy. He suggested selling the shares the moment company has or almost reached the peak of its growth. Also, sell the shares the moment you realise you have made a mistake in the initial selection of the shares. The only option to decide when to buy and sell high priced shares is to identify the individual merit or demerit of each of the shares in the portfolio and arrive at a decision.

Carter Randal (1992) offered to investors the underlying principles of winning on the stock market. He emphasised on long-term vision and a plan to reach thegoals. He advised the investors that to be successful, they should never be pessimists. He revealed thatthough there has been a major economic crisis almost every year, it remains true that patient investors have consistently mademoneyin the equities market. He concluded that investing in the stock market should be an un-emotional endeavour and suggested that investors should own a stock if they believe it would perform well.

S. Rajagopal. (1996) commented on risk management in relation to banks. He opined that good risk management is good banking. A professional approach to Risk Management will safeguard the interests of the banking

institution in the long run. He described risk identification as an art of combining intuition with formal information. And risk measurement is the estimation of the size, probability and timing of a potential loss under various scenarios. Charles. P. Jonesl8 (1996) reviewed how to estimate security return and risk.

To estimate returns, the investors must estimate cash flows the securities are likely to provide. Also, investors must be able to quantify and measure risk using variance or standard deviation. Variance or standard deviation is the accepted measure of variability for both realised returns and expected returns. He suggested that the investors should use it as the situation dictates. He revealed that over the past 12 years, returns in stocks, bonds, etc. have been normal. Blue chip stocks have returned an average of more than 16% per year.

He warned that the investors who believe that these rates will continue in the future also, will be in trouble. He also warned the investors not to allow themselves to become victimised by " investment gurus". Rukmani Viswanath (2001) reported that the Primary Dealers in Govt. securities are working on a new internal risk management model suited for the Indian market conditions. Theattempt is to lay down general parameters for risk perception. The Primary Dealers Association of India (PDAI) is formulating a set of prudential norms for 'risk management practices'.

While internationally the principles of risk management may be the same everywhere, the Association is of the view that they have to identify the relevant issues and apply those principles in the Indian context. It strongly argues that it must work on a model that can help to manage liquidity and

interest rate risk. While the existing RBI guidelines on risk management cover mainly statutory risk, the PDAI hopes that its new risk management model will be able to perceive 'real risk'. These new norms are expected to help gauge several issues like, whether a fall in the prices of securities or yields is a temporary or permanent situation etc.

The areas the new norms are likely to address are the assessment of the liquidity situation and envisaging investor appetite for a specific instrument and their appetite for risk. According to thegovt. securities dealers, these norms are expected to help them hedge.

FOOTNOTES

1. Grewal and Navjot Grewal, Profitable Investment in shares, Vision Books Pvt. Ltd. 36 Connaught Place, New Delhi 1984.
2. Jack Clark Francis, Investment - Analysis and Management, MC Graw Hill, International Editions, 1986.
3. Preethi Singh, Investment management, Himalaya PublishingHouse, Bombay Nagpur and Delhi, 1986.
4. Lewis Mandell, Investments, Macmillan Publishing Company, New York, 1992.
5. Nabhi Kumar Jain, How to earn more from shares, Nabhi Publications, Delhi, 1992.
6. Carter Randall Non-stop ~winning from the stock market Vision Books, New Delhi, Bombay (1992).
7. S. Rajagopal,. " Bank Risk Management - A risk pricing model", State Bank of india, Monthly Review, Vol. XXXV, No. 11, November 1996, p. 555.

8. Rukmani Viswanth, " PDs working on Risk Management Model", TIE Hindu, Business Lime, Daily, Voi. 8, No. 17, January 18, 2001, p. 11