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Emerging Equity Markets in India: A Case Study

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Abstract

The past two decades have been a period of tremendous growth in the emerging equity markets of certain developing countries. Park and Agtmael (1993, p 47) report that, at the start of 1970, 32 developing countries had securities markets or stock exchanges. However, only a few actually functioned. Six had some form of securities legislation or commission. As of 1993, over 50 developing countries had securities markets and 21 had securities commissions. They also report that, during this period, the total equity market capitalization of these developing countries grew from US $50 billion to almost US $700 billion and the number of listed companies more than doubled. The purpose of this study is to review the major factors and characteristics that prompted this growth and in so doing provide a blueprint for other emerging democracies as they begin to develop efficient securities markets as part of their effort to forge strong market economies. In this paper, India will be used as a case study of how one country has both succeeded and struggled in implementing some of these factors.

The rest of the paper is organized as follows: section I provides an introduction and defines the term "emerging market," section II reviews several fundamental preconditions for equity market growth, section III describes several specific factors that encourage growth in emerging equity markets and the summary and conclusion are presented in Section IV.

I. Introduction

It is difficult to find a consensus definition of an emerging market largely because countries fall along a spectrum of development from rudimentary to mature emerging markets. India, an emerging market example, has the following characteristics which could serve as a definition. Gross domestic product per capita substantially below the average for developed economies; greater government regulation limiting or banning foreign ownership in domestic companies; a lax and/or corrupt regulatory environment; inefficient back office operations including clearing and settlement capabilities; restrictions on repatriation of initial capital, dividends, interest and capital gains; greater perceived investment risk than in developed markets and a general perception by the investment community that the country should be considered emerging.

The word emerging implies a state of change in a favorable direction. But to be recognized as emerging a country needs to be seen to be making progress in that direction. This recognition is a critical ingredient as this will generate confidence in the international investment community, which in turn will encourage foreign direct investment and the resultant economic growth.

In order to provide a further backdrop within which specific positive growth factors can be analyzed, it is helpful to consider several broader stages of development common to all equity markets. It should be noted here that the duration of these phases may vary according to the country and time frame within which an emerging market's

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evolution occurs. Periods of global economic expansion tend to accelerate the development of capital markets.

Papaioannou and Duke (1993, p 36) suggest four stages of development. First, equity markets tend to develop only after a country has achieved a degree of economic and political stability and begun implementing growth-oriented policies. In this phase, equity prices tend to rise encouraging the confidence of domestic investors. The market becomes more widely accepted as an investment alternative to traditional bank deposits and government securities.

In the second phase, because the equity market now has some degree of credibility, pressure abroad for greater accessibility and at home for cheaper capital funding leads to a loosening of regulations in the domestic capital markets. As investment bafflers decline and as market liquidity and risk-adjusted returns increase, international investors begin to realize the diversification benefits of investing in such markets.

In the third stage, the market offers the prospect of higher, less volatile returns, and investors easily absorb new issues of stocks and bonds. The volume of new issues increases as firms strive to pay down debt and private or newly privatized companies make their initial public offerings. Trading volume increases, producing greater market efficiency, while the growing need for a risk transfer mechanism spurs the development of equity and currency-hedging instruments such as derivatives.

In the final phase, equity risk premiums fall to internationally competitive levels relative to short-term money market rates. The equity markets begin to achieve the stable growth that marks a mature or developed country.

II. Fundamental Preconditions

There are several fundamental preconditions that appear to be necessary to create a fertile environment for the institution and development of an emerging stock market. These are structures, reforms and even economic philosophies that need to be either in place or in process before specific factors unique to fostering growth in equity markets are considered. Without the structure provided by these preconditions, other steps meant to encourage growth in equity markets are likely to prove futile.

Government Commitment. First, economists and government financial officials need to be convinced that financial markets in general and equity markets in particular play a significant and positive role in economic development. This attitude can evolve as policy makers understand that equity markets do not always take the form of high risk gambling houses that drain away financial resources from the real economy and misuse human resources. Strong equity market growth in developing countries is usually partially the result of far-sighted, strong leaders who had the vision, understood the issues and were prepared to face down the disbelievers and the fainthearted.

Beginning in the early 1990's, the Indian government began a process that indicated a commitment to equity market growth. They saw these markets as a financial activity equal to banking. While there is no question that the banking system is the central part of any national financial system, it is sometimes missed that securities markets are equally important, albeit in a different respect. While a country cannot get along without a financial payment and clearing system, it is equally true that, if it is to

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have a market economy, it cannot get along without an equity market either. There needs to be a recognition that banks should not be providing 100% of business' financing requirements; they need adequate equity bases to support their loans. Park and Agtmael (1993, p 54) concludes that financial systems that favor the banking system at the expense of equity markets are often doing damage to banking and impeding efficient economic growth.

Policy makers need to see the value of equity markets as a means of broadening the ownership base of large family-owned enterprises and as a critical element in the process of privatization. This equity infusion indirectly improves the distribution of income. In addition, government officials need to see equity markets as an efficient way of increasing domestic savings and providing more reliable long-term finance for industry. In sum, government understanding, will, and commitment toward developing an equity market is the crucial first precondition. Of course, this precondition is based on the assumption that a reasonably stable political environment is in place.

Market Economy and Legal System. Second, a basic market economy and legal system must be in place. Such a system would include some form of contract law, company law, and banking law along with a justice system that is able to enforce the laws effectively. Financial market participants need the assurance that private contracts will be honored and enforced and that appropriate dispute resolution mechanisms exist. If these do not work or are faulty, the crucial ingredient of investor confidence will be difficult to establish and attempts at inducing broad participation in an equities market are likely to fail. Once credible contract law and a system of enforcement is in place, the next step is enacting a securities law based on these building blocks to enforce investor protection and promote securities market development. Suggestions regarding securities law are discussed in the next section on factors specific to equity market growth. The establishment of a formal securities commission or similar organization was often a result, as well as a means, of furthering these objectives. Due to its English heritage, India has a legal system in place and well established contract law. The Securities Exchange Board of India (SEBI) was established in 1988 to enact and enforce securities law. In June 1992, SEBI issued guidelines regarding information disclosure and investor protection. As a result, India has a good legal and regulatory structure in place.

Commitment to Education. Third, good quality education from grade school through higher education must be available for the general population. This is essential for developing the academic and technical skills needed to provide the infrastructure for an efficient market economy as well as a competitive equity market. In India, the Bombay Stock Exchange has instituted a course of study to train market participants and prepare them for qualifying exams necessary to become brokers or exchange members.

III. Factors Specific to Emerging Equity Market Growth

Economic Development and Reform. Emerging countries that have witnessed equity market growth are typically characterized by several government macroeconomic reform efforts. These include privatization, easing of price controls and subsidies to producers and consumers, and instituting growth promoting monetary and fiscal policies that have stabilized inflation and exchange rates.

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The worldwide trend toward privatization has given greater depth to emerging capital markets. This sale of state-owned enterprises to private owners is subjecting the managers and work force to the tests of market productivity. These sales have been a key factor in equity market growth as they have increased the supply of stock available to investors and stimulated businesses to offer their own shares to the public. This has increased the demand for investment banking, valuation and other securities market services. Privatization has also helped open financial services such as mutual funds and pension funds to the private sector for the first time in several countries.

Monetary and fiscal policies constitute a major source of risk in equity markets, because monetary instability and fiscal imprudence create financial uncertainty that may seriously impair market functioning and performance. For example, unanticipated inflation transfers wealth and income from lenders to borrowers, driving investors out of securities and into real assets (such as gold and real estate) that are traditionally believed to offer protection against purchasing power risk. In their attempt to promote the growth of the investment sector, governments may be tempted to compromise fiscal and monetary discipline by financing public or private sector projects via government spending. This may create instability, most often manifested by higher inflation and excessive exchange rate volatility.

Emerging countries should also avoid implementing a strict monetary policy that is not accompanied by a serious reduction in the budget deficit. A failure to do so may lead to public sector expansion at the expense of the private sector, high real interest rates and an overvalued currency. This in turn hurts exports as well as capital inflows since an overvalued exchange rate often inhibits direct and portfolio investment because of the increased expectation of a subsequent currency devaluation.

To encourage sustainable, noninflationary growth and promote investment, emerging market countries should follow relatively strict macroeconomic policies. For example, India has generally succeeded in instituting growth policies while simultaneously keeping the budget deficit in check, increasing foreign reserves and keeping inflation and exchange rates under control. As a result, an increase in private investment, new public offerings, equity market capitalization and economic growth has occurred. See Table 1.

Regulatory Structure and Reform. An important ingredient for growth in emerging equity markets is the liberalization of government controls and regulations that have distorted and impeded development by restricting access by foreigners. These include the removal of barriers on foreign direct and portfolio investment, more flexible foreign exchange arrangements, differential tax treatments that discouraged financial flows into equities, and the reduction of excessive licenses and tariffs.

Countries wishing to promote their fledgling equity markets need to overcome the xenophobic attitude toward foreign investment. *The Stock Exchange Review* (1996, p 8) reports that when India decided to remove limits to foreign portfolio investment in 1991, the amount invested jumped from $8 million to $4 billion by March 1996 or 4% of total market capitalization. Foreign institutional investors are free to invest in all equity securities subject to certain caps, and can repatriate capital gains and dividends subject to taxes. As a result, foreign institutional investors have grown from none in 1992 to 258 by March 1996. Mobius (1994, p 2) suggests that one solution to

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Table I Bombay Stock Exchange Indicators as of Year Ending in March					
	1991	*1992*	*1993*	*1994*	*1995*
No. of Listed Companies	2471	2601	2861	3483	4105
Average Daily Turnover (In US $Billion)	0.06	0.10	0.07	0.12	0.11
No. of Shares Traded (In Million Nos.)	337744	635515	350313	677019	575328
Market Capitalization (In US $ Billion)	23.92	97.13	59.72	109.52	130.42
BSE Sensitive Index	1167.97	4285.00	2280.52	3778.99	3309.48
Source: Bombay Stock Exchange Research Department					
Economic Indicators - India (March year end)					
Item	*1991*	*1992*	*1993*	*1994*	*1995*
Real GDP Growth Rate (%)	5.2	1.2	4.2	4.0	4.2
Gross Domestic Saving as a percent of GDP at Current Market Prices	23.7	23.8	22.5	21.4	21.7
Gross Fiscal Deficit as a percent of GDP at Current Market Prices	8.41	5.96	5.22	6.38	5.91
Current Account Deficit as a percent of GDP at Current Market Prices	33	0.9	2.1	0.5	1.2
Trade Balance (in US $ Billion)	-9.43	-2.12	-4.10	-1.24	-2.13
Foreign Exchange Reserves (US $ Billion)	5.83	9.22	6.42	12.74	16.37
Annual rate of inflation	12.1	13.6	6.8	8.5	10.3
Source: Bombay Stock Exchange Research Department					

this fear of foreign control and ownership is to create a single "golden share" in each listed company which will have the power to prevent control of the company from being taken over by foreigners. In this way foreign investors are free to purchase all the shares of a company and thus contribute to the overall market liquidity. While India has not instituted this policy, it does allow foreign institutional investors to hold up to a *5%* stake in any group and up to a 24% stake in a single company.

As part of the process of promoting emerging equity markets, countries need to gradually ease and eventually eliminate foreign exchange controls. This normally

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takes place in conjunction with improvements in government finances, overall macroeconomic policies, and the development of a legal and institutional framework for financial markets. The existence of any type of foreign exchange control presents a considerable barrier to market entry by foreign investors whether direct or an international fund manager. It adds another element of risk to an investment that is already fraught with uncertainty. Such controls may make it difficult to transfer interest, dividends and capital gains out of the country. Countries that create bureaucratic delays before funds can leave increase the risk of foreign exchange losses. In addition, some countries prohibit the earning of interest on funds tied up in the transfer process. Thus a foreign investor could face the unhappy prospect of sitting on deposits not earning interest with a steadily devaluing currency.

Although taxation is necessary, it should be efficient, fair and encourage savers and risk takers, both foreign and domestic, to invest in equities. Currently many countries, the United States included, reward companies that finance through borrowing as interest on debt is often tax free to savers and a tax deductible expense for borrowers while both dividends and capital gains are taxable. Countries wishing to promote their small emerging equity markets should take a different course. Income earned from equities should be taxed on the same basis or even at a lower rate as income from other debt instruments. Capital gains should not be taxed at all. A capital gains tax especially discriminates against foreign investors as they cannot easily reflect capital losses to the extent domestic investors may. This tax policy will encourage capital formation and investor acceptance of the greater risks that go with equity investment. In addition, corporate taxes should encourage balanced company capital structures and securities transactions should be exempt from stamp or transfer taxes to encourage liquidity.

Tax policy should also encourage owners of businesses to issue common stock through the market in order to broaden ownership and reduce dependence on debt. This will accomplish government economic as well as political goals as expanding enterprise ownership tends to increase social stability in poor countries. This has been a central theme in privatization programs. Many countries, previously sceptical about the practicalities, found that policies that increased the supply of equities seemed to produce a demand from savers that was never recognized before. A further result has been increased public support for a market economy.

Emerging equity markets can also be promoted by easing licensing requirements. By making it difficult to obtain licenses for new projects, governments have favored local enterprises effectively creating cartels that have been inefficient and poorly managed. Reducing bureaucratic restrictions creates an environment where there is less discrimination against local newcomers and foreign investors, thus encouraging investment, competition and equity market growth.

India is an example of a country whose economy and emerging equity markets have benefited from some of the above mentioned liberalization policies. As reported by Jacob (1994, pp. 100-104), India's economy was in trouble in 1991, with high inflation and low foreign exchange reserves. In July of that year, the Indian government instituted several key changes. It eliminated most forms of import licensing, cut tariffs to a maximum of 65% from 400%, eased restrictions on foreign investment, made the rupee convertible for trade and restored fiscal order. By 1993 inflation was around

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7%, foreign reserves were around $6.5 billion, exports were up 20% and foreign investment inflows, including stock purchases, hit a record $4.7 billion. In addition, on the Bombay Stock Exchange the amount of capital raised via new issues increased fourfold, annual volume doubled, number of companies listed increased 50% and total market capitalization increased fivefold (see Table 1). This stock market growth was also sparked by other factors such as structural changes in the operation of the equity markets. These factors will be discussed next.

Legal Structure Reforms. The development of a legal framework that will ensure adequate protection of investors and thereby foster confidence in the market is essential. Guy (1994, pp *4,5)* suggests a framework that includes: 1. a law that would deal with all aspects of the regulation of the market. A separate law, as opposed to trying to regulate the market through Company Law, would facilitate regulation and would provide flexibility to adapt to new situations. 2. the creation of a regulatory body responsible for the regulation of the markets. Preferably this body would be independent of the political structure. The chairman and other key officials should be appointed for a fixed term so that they are not subject to political pressures. The exchanges should have their own regulations and compliance structures thereby acting as the first line of regulation. The government created regulatory body would then provide general oversight and take up enforcement actions not properly handled by the exchanges. 3. rules concerning the public offerings of securities, ongoing company disclosure obligations and insider reports. 4. provisions concerning secondary equity market operations and the depository and/or settlement body that should be developed. The exchanges, depository and other equity market intermediaries should be allowed to develop their organizations while remaining under the oversight of the public regulatory body. These market organizations should be constituted as self-regulatory bodies that eventually, when they have reached a satisfactory level of maturity, would be responsible to administer and apply certain aspects of the regulation. 5. rules concerning the protection of minority shareholders. 6. rules concerning certain fraudulent practices like insider wading and market manipulation, and 7. appropriate penalties to ensure compliance with the legislation. The creation of such rules and penalties in India has been instrumental in the growth of their equity markets.

Market Structure Reforms. Even if proper macroeconomic policy and regulatory liberalization is instituted as suggested above, an archaic and inefficient financial market structure will thwart an otherwise favorable environment for emerging equity market growth. Governments need to pass laws and otherwise encourage the creation of efficient wading, clearing and settlement systems, trading transparency, accurate pricing information and market integrity.

Domestic and especially foreign investors are very concerned about settlement requirements and systems since any problems in this area could result in defaults, delayed payments and additional costs all of which increase the liquidity risk to the investor. For example, the settlement process as it presently exists in India suffers from the vast amount of paperwork that is generated in the process. Trades are settled by physical movement of paper requiring various signatures along the way. The exchanges aggregate trades over a period of one to two weeks and carry out net settlement through physical delivery of securities. The process of physically moving the security from the seller to his broker to the buyer's broker and ultimately to the buyer takes time which gives rise to settlement risk as delays occur somewhere along the

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chain. With the increasing number of transactions, the paperwork burden is threatening the functioning of the equity markets and investors face one more risk of participation.

Internationally, the trend is toward shortening the settlement period. There are primarily two types of systems followed. In one system there is an accounting period (of 7 to 30 days) over which total trades are aggregated, which is followed a few days later by the settlement of aggregated net trades. In the other system, which has become the norm now, each day constitutes an accounting period and that day's trades are settled after 3, 5 or more days. This is known as rolling settlement and is used in markets in the United States, Japan and Germany among others. The goal for settlement systems worldwide is three days after the trade takes place or T+3.

In order to attract investors, emerging stock markets need to obtain the worldwide norm of quick settlement. India is developing a system whereby the clearing and settlement functions are entrusted to a single independent private organization that has the responsibility to establish a centralized depository with a book-entry system that would be integrated with an electronic settlement system. They are starting with a system of immobilization of the certificates in a depository and a book-entry system. But, the legislation drafted in India provides for full dematerialization (the elimination of securities certificates) as soon as the centralized depository system is operational and investors feel comfortable with it.

The depository would be the registered owner of securities deposited with it. The beneficial owners of the securities held in the depository would be the actual owners who would hold them through the depository. While securities would be registered in the name of the depository, all economic benefits and rights from owning the securities would continue to accrue to the beneficial owner. The depository would be subject to government securities regulations. For speedy settlement, securities held in the depository need to be freely and easily transferred. As such, there should be no requirement to attach a distinctive number to every certificate.

In addition to efficient settlement procedures, countries with emerging equity markets should put into place trading systems that insure maximum liquidity and transparency. Investors in their attempt to maximize returns must keep trading commissions and costs at a minimum. This can be achieved through efficient stock market settlement and trading systems. With the advent of larger capacity and faster computers, the computerization of stock market operations is making great strides in efficiency possible. This leads to lower trading costs (for example, paperwork savings) and greater accuracy which, in turn, leads to increased trading and liquidity.

In a related matter, market participants desire wading transparency and accurate pricing information. In order for the investor to determine the correct price at which to offer shares for sale or to bid for the purchase of shares, information regarding the nature of the bids and offers is essential. The size and pricing of bids and offers on the exchange should be accurately reflected to market participants in a fair and equitable way. This information must be timely and ideally available to all during the time the exchange is open or at least immediately after the close of trading. Most major international fund managers subscribe to a number of expensive stock price information systems such as Reuters. However, some markets are not sufficiently covered by

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these services or not covered at all. In some cases, this is because the host country stock exchange restricts the release of such information to independent information services. This is a major impediment to investor participation. Emerging stock markets should freely make available such information and even subsidize its dissemination worldwide since this will greatly increase the market's attractiveness and increase trading volume.

Internationally, the trend is away from floor based, open outcry systems toward screen based trading systems. A floor based system where physical transactions take place imposes limits on the trading volume that can be handled, increases chance of error and is generally more costly to operate. Hence, the speed with which new information can be incorporated into prices is slowed. Most emerging markets and many mature equity markets are instituting screen based systems to meet the growth in trading volume, to satisfy the needs of institutional investors and to take advantage of the sophisticated trading technology now available. These systems. which electronically match buyer and seller in order driven systems, or which find for the customer the best price available in quote driven systems, have cut down on transaction time and cost and have reduced risk of error, as well as fraud.

They enable distant participants to trade with each other, improving the liquidity of the market. The high speed with which trades can be executed, and the large number of participants who can trade simultaneously, allows faster incorporation of price sensitive information into prevailing prices, thus increasing the informational efficiency of markets. With a screen based trading system, it is possible for market participants to see the entire market, which increases the transparency of the market and hence leads to increased investor confidence in them. These systems also help to establish transparent audit trails which, given the potential volume and speed of trading, is important in maintaining control and preventing fraud. Exchanges in Vancouver, Australia, Hong Kong, Thailand, Taiwan, London, and Singapore have either instituted or are moving toward screen based trading. Exchanges such as the New York Stock Exchange, which still have an element of open outcry, have parallel systems for screen based wading.

An example of a state of the art automated trading system is the National Stock Exchange in India. The country, after instituting economic reforms, saw tremendous growth in new stock issues, volume and number of shareholders. Steiner (1993, p 14) reports that against the backdrop of almost 25 million shareholders scattered all over the country and a telephone system that is cumbersome at best, the NSE was established. For example, of the phoned orders that do finally arrive at trading floors, traders have time to execute only a third on any given day. The NSE could improve on this as it is essentially a computer system linked to a satellite network that ultimately should allow investors to wade shares listed anywhere in India from almost anywhere else in the country. Regulators in India hope the system will revolutionize the existing market's 19th century rituals of manual deliveries and written log entries.

A related reason for new emerging equity markets to strive to put into place the most efficient trading systems is market integrity. The issues of integrity of transactions in markets and fairness in dealing are of utmost importance from the point of view of maintaining investor confidence in the markets. Domestic and especially foreign investors must have faith in the liquidity of the markets, and in the fairness and

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transparency of price formation. The concept of wading "fairness" implies that each market participant will have equal access to shares at a given price. It means that when a seller offers stock at a given price, all buyers will have access to that offer and when a buyer offers to purchase, all sellers will have access to that offer. Emerging markets should discourage broker conflicts of interest. For example, if a broker is also acting as an underwriter, corporate financier, fund manager and also operating a wading account for his own benefit, it is extremely difficult for him to resist the temptation to take advantage of buy or sell orders placed by his clients. When the client places a buy order at a given price and the market price is lower, the broker may first purchase at the lower price for his own account and then turn around and sell it to his client at the higher price.

As third-world economies open up and securities markets grow, it will be increasingly important for issuers, markets and related intermediaries to be sensitive to the question of investor confidence. The success of regulators in promoting the integrity of markets will depend on their effectiveness in investigating market abuses and in imposing deterrent penalties.

Financial Intermediary Requirements. Worldwide, there are two major models of financial services intermediation. One is a structure of universal banks that are allowed to trade in securities and underwrite public offerings thus attempting to integrate banking and securities market services. The other is a structure of independent intermediaries, brokers and investment bankers. Guy (1994, p 6) points out that although integration provides certain efficiencies, there is evidence of the weakening effect it has on equity market development and the risks of abuses resulting from concentration of financial power and conflicts of interest. He provides evidence that countries with universal banking systems have smaller and less efficient equity markets and greater concentration of economic power than those countries that separate the banking and securities underwriting functions. Countries with emerging equity markets need to ascertain which structure will foster growth in the economy and meet equity market needs in a competitive environment. Firms in financial services which are exposed to competition from domestic and foreign firms are the most innovative and cost effective in meeting the needs of investors and issuers.

However, small emerging markets often do not have sufficient numbers of intermediaries to ensure coverage of the market. In these cases, allowing banks to set up independent fully capitalized subsidiaries as brokers, investment dealers and underwriters may be the only option. This will ensure that these subsidiaries will be interested in providing sufficient resources in their operations to properly service their customers. India has taken steps to ensure intermediaries meet minimum standards. They have a system of registration of intermediaries to ensure that these firms are properly qualified to serve the financial needs of customers. They are devising regulations and codes of conduct to ensure that intermediaries act in the best interests of their customers. Regardless of the structure or related regulation, growth in emerging equity markets is contingent upon a solid and growing structure of financial services intermediaries.

In the case of foreign portfolio investment in emerging markets, a financial services entity of crucial importance is the local custodian. Settlement procedures in these markets can be inefficient and/or confusing. Foreign investors find the key to mini-

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mizing problems and maintaining a good settlement record is the use of a knowledgeable and efficient global custodian with a good subcustodian network of brokers and back office expertise. The custodian plays an integral part in the settlement/custody process by providing custody and registration of shares, foreign exchange services and tracking and acting on corporate actions such as dividends, proxies and splits. In addition, they make payment for shares, receive or disperse share certificates, provide cash management and tax reclamation, as well as perform the basic daily settlement duties related to trading. Countries with emerging markets should be aware that if there are no local banks with the experience or ability to undertake the custodian functions, foreign investors are unlikely to invest.

Company Information Disclosure and Internationally Recognized Accounting Standards. An emerging equity market will have difficulty growing if investor confidence is lacking due to inadequate disclosure of company information. Good information is especially critical for foreign investors whose willingness to invest in an emerging market is largely driven by the ability to obtain and effectively analyze company information. One of the key tasks of government securities regulation should be ensuring that listed companies make full and fair disclosure of company information. Disclosure requirements should cover the initial offering prospectus as well as a system of continuing disclosure of relevant shareholder information. Full disclosure means that all information relevant to the business operations is made to investors so that they can make an intelligent and informed assessment of the firm's performance and prospects. Fair disclosure means that the information must be revealed to the entire market, at the same time and in the same degree and not only to a few insiders. It also means that qualified, independent auditors should be made responsible for preparing company statements which are complete and detailed enough so that they fully reflect the operations, problems, risks and performance of the company.

A vibrant equity market is predicated on company information that has a high degree of accuracy, is comparable across firms, is highly visible, widely distributed and actively used. This ensures that successes and failures of firms become common knowledge, forcing both private and public sector managements to perform or face replacement. This also increases investor confidence, willingness to participate in the markets and aids in proper regulation of the market. One key step in providing such information is the adoption of internationally recognized accounting and auditing standards. New emerging markets should not attempt to develop their own standards, if they have no standards in place. In the first place, many emerging markets do not have the professional structure in place to develop adequate standards. Secondly, and more important, it is best to adopt an internationally recognized and accepted set of accounting standards, specifically the International Accounting Standards published by the International Accounting Standards Committee. When there is no international standard to cover a particular situation, then the country should develop one of their own. In the early stages of market development, it is important for the securities regulatory agency to retain authority over the standards that will be acceptable for listed companies. In addition, the regulatory agency should have the power to impose standards on the listed companies to ensure comparable and full financial disclosure to the public.

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India is an example of a country that is part way toward achieving these objectives. Through the British system there are, in place, accounting standards that are generally followed. And, the Institute of Chartered Accountants of India provides some oversight and promotes India's version of generally accepted standards and practices. However, Indian accounting standards need changes that will make them comparable to international standards. For example, Indian standards do not require cash flow statements. Subsidiary accounts and statements are not required to be consolidated with those of the parent company. Internationally, financial results are published quarterly, while under Indian accounting practice, financial results are only required at half yearly intervals. One of the goals of The Securities and Exchange Board of India is to improve the quality of accounting standards and practices.

Education and Training for Financial Market Participants. For an emerging stock market to grow and gain international respect, local intermediaries, brokers and other participants need to be well trained thus providing a pool of highly trained professionals. Brokers should be required to pass a securities examination before being allowed to advise and act on behalf of clients. A course of study should be developed and be made widely available so that prospective market participants are adequately prepared to take the examination. In addition, information programs should be developed and made available to the public so that they can get basic information on the purpose and functioning of the equity markets and also on the investor protection provided by government regulation and self-regulatory bodies.

India is implementing many of these ideas through the training centers at the Bombay Stock Exchange and the UTI Institute of Capital Markets. The Securities and Exchange Board of India (SEBI) has mandated that stock exchanges require new members to meet professional standards through written and oral examinations.

IV. Summary and Conclusions

Facing stagnant economies, inefficient companies and reluctant creditors abroad, many emerging countries have been compelled to take steps to stimulate the growth of a dynamic and competitive private sector. The creation of efficient equity markets is seen as a critical part of this process as well as a means to decrease overreliance on debt finance. This paper has used India as a case study to illustrate several factors and characteristics that are essential to growth in emerging equity markers. They range from reforms in market, regulatory and legal structures to monetary and fiscal policy reform measures. Countries need to continue lowering such bafflers to investment as legal hurdles, high and variable inflation, the absence of a solid regulatory and accounting framework, inadequate clearing and settlement procedures and poor investor protection. The underlying theme in all of these is to create an environment where equity investors feel confident in the fairness and efficiency of the market.

The prospects for continued substantial foreign and domestic equity investment in India and other developing countries are favorable. Like India, many are experiencing above average economic growth, have appealing untapped potential, a growing middleclass and, because they are still underweighted in the portfolios of developed country investors, they are likely to continue to attract investors for some time to come. However, foreign investors realize the risks in these countries, thus emerging markets must continue to take steps to encourage and sustain these private capital

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flows. This calls for maintaining a stable economy and an investor-friendly environment which, in turn, will lead to the most efficient allocation of available capital.

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