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GLOBALIZED INTEGRATION OF STOCK MARKETS OF WORLD

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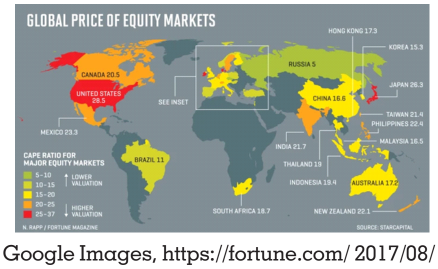
ABSTRACT Cointegration of the markets is highly debatable topic and over the years the researchers are trying hard to come a definite conclusion about the degree of dependency of each stock market on one another. The developed markets affect the developing stock markets and in turn are also affected by them. The paper is an attempt to discuss the various factors that may give the discussion a pointed direction before one draws an inference about the global integration of world stock markets.

KEYWORDS : Stock Exchange, BSE, Global capital markets, Cointegration

Indian economy, before liberalization, was under tightly controlled measures like licensing, investment restrictions (core sectors only), high tariffs and rates. Mounting current accounts deficit made the growth of the economy unsustainable because of dependence on borrowings. The financial sector was unstructured and has only few financial securities. The introduction of economic policy 1991 reduced the imbalances and to implement the structural reforms. With the purpose to regularize the investments, mobilize investments and credit, structure the security market, a regulatory body The Indian capital Market has seen rapid and visible changes with the liberalization and globalization. The impact of liberalization, privatization and globalization has touched almost all the sectors of Indian economy, particularly the Capital market. The capital market plays a vital role in the development of financial sector. The various factors like investment climate, performance of industry and service sectors, macro-economic variables and global business environment have an impact on and affect the growth and development of an economy.

With the deregulation and globalization, Indian stock market has seen radical changes in the functioning and conduct of stock market and its functioning has been competitive and more efficient. With the rise in investors' participation in equity markets across the globe, Indian market also witnessed a significant shift proportion of domestic as well as foreign investors. Foreign investment plays a significant role for every economy, particularly in realizing the existing potential in the under developed and developing ones. Though the developed countries need it to boost the sustainability, the developing countries require it to increase the rate of investment growth and to accumulate it for intensive economic growth. The Figure below gives a glimpse of global price of equity markets of world



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IMPORTANCE OF STOCK EXCHANGE

Among the great variety of institutions that pursue the objective of providing service to the modern society, stock exchanges can be easily regarded to play the most critical role as the "agents and facilitators of entrepreneurial progress". The onset of the Industrial Revolution resulted in substantial growth in the size of business enterprises. Such enterprises needed large amounts of investment, which could no longer be provided through proprietorships or partnerships, the traditional modes of doing business till then. Besides, these proprietorship or partnership form of business had always suffered from certain weaknesses. For example, small-time proprietors, or partners in a proprietary or partnership firm cannot easily leave the firm whenever they would like to. The reason behind this is that it may not always be possible to find buyers for the entire business, or even a part of the business, whenever the proprietors would like to sell it. Again, it is difficult for a person with limited savings to take advantage of proper business opportunity by utilizing their limited means. Such problems can be even more complicated for large proprietorships and partnerships. Generally, people will avoid investing in such firms, as it is very difficult to convert the invested savings into cash. Besides, there may be more convincing alternatives for converting these savings into cash (e.g., better investment opportunities, marriage, education, death, health, etc.). Hence, it follows that the only proper alternative for large enterprises is to have a system where people own parts or shares of a business and can buy or sell that share (or those shares) at their own convenience and according to their existing requirements. Therefore, it follows that such a system involves division of the ownership of the business into numerous units so that each and every unit can be bought and sold independently and easily without affecting the operations of the business. It acts as a medium for directing small savings of the economy towards the entrepreneurial ventures.

In modern companies, the objectives mentioned at the outset are attained through the system of shares. It can be easily understood that a share stands for the smallest unit of ownership in a publicly owned company. A share certificate validates the ownership of each such fraction. As the total ownership of the company comprises of many such fragments, each of which is signified by the holding of a share certificate, it gives rise to a system that supports easy buying and selling of such ownership.

Existing Problems in the Stock Markets

While stock markets undoubtedly provide some benefits in terms of availability of easier avenues for financing to the companies, greater opportunity for the general population to participate in such initiatives and better utilization of the savings of the general public, there are also some inherent problems in this mechanism which are yet to be fully addressed. Some of the more fundamental problems in this regard are as follows:

(1) Despite the widespread popularity of the stock market mechanism, ultimately it represents only a microcosm of the real economy. This implies that the stock market can never be regarded to be truly representative of the real economy.

(2) Since the stock market is supposed to provide a reflection of the future, it is highly sensitive to events like the policies of governments or central banks, unemployment data or consumer spending. For this reason, major occurrences like the recent sub-prime crisis in the USA, political instability, war natural disasters, etc. can act as a trigger for spectacular market crashes. Similarly, happenings with significant positive fallouts like the election of a popular government, investor-friendly measures taken by the state, etc., can bring about major upheavals in the market.

(3) Stock prices can be highly fluctuating in nature. Such fluctuations may be much larger than the actual change in worth of the companies underlying the security. Further, such rise or fall in prices may be accentuated through statements from political leaders, major business personalities and respected market specialists. This can lead to creation of market bubbles, ultimately ending in a market crash.

(4) False or misleading information may result in unnatural price changes that have no link with reality. A significant amount of trading activity takes place on the basis of 'insider information', where the ordinary investor ends up as the ultimate loser.

(5) Human psychology is a vital ingredient in the operation of stock market. Investors often resort to the 'herd mentality'. Instead of making their own decisions, people simply opt for the path chosen by others. This is a common mistake in investing which can have an important bearing on the markets.

(6) Due to the unpredictability and risk which is obvious in the stock market, many people avoid investing in these markets. This is particularly true for countries like India. As a result, the market cannot become broader based. Consequently, a limited number of individuals or institutions trading in substantial amounts can have a distortive impact on the market. This is not desirable.

Concepts of Index numbers

The market Index captures the pulse of the economy for the ordinary person. Indices have been commonly utilized as sources of information. In other words, a perusal of index values during a particular period of time can give a fair idea about the market performance at that point of time. In addition to this fundamental requirement, indices today satisfy new uses as index funds and index derivatives. With the help of index derivatives, not only can investors easily decide on the appropriate amount of risk exposure to an index (a practice which is known as hedging), but they can also implement forecasts about index movements (a practice which is known as speculation). In the modern economy the idea of risk management has been developed around the use of index derivatives in hedging activities.

It is obvious that a good stock market index is one that provides snapshot of the behavior of the overall equity market. The basic thing is that the market index should be not only liquid but highly diversified also.

OVERVIEW OF INDIAN CAPITAL MARKET

Jensen (1978), has defined market efficiency as "A market is efficient with respect to information if it is impossible to make economic profits by trading on the basis of information."

Whereas Malkiel (1992) has a different notion: "A capital market is said to be efficient if it fully and correctly reflects all relevant information in determining security prices. Formally, the market is said to be efficient with respect to some information, if security prices would be unaffected by revealing that information to all participants. Moreover, efficiency with respect to information implies that it is impossible to make economic profits by trading on the basis of information."

However, Dyckman and Morse (1986) considered market as: "A security market is generally defined as efficient if the price of the security traded in the market act as though they fully reflect all available information and these prices react instantaneously, or nearly so, and in unbiased fashion to new information".

RELEVANCE OF COINTEGRATION AMONG MARKETS

While stock markets themselves can vary from country to country in terms of depth of the market, the securities and trading instruments, and indeed the nature of economic performance, the corresponding indices can also differ from one another with regard to the method of computation,the mode of selection of scrips for the calculation of the index, as well as the number of such scrips utilized for this calculation. In an era when globalization and liberalization have become common place in the business lexicon in the hitherto insulated developing nations, it has become customary to address the issue of integration of markets around the world. This issue holds particular relevance in a country like India where at one time the protectionist policies of the government ensured that the economy remained protected from occurrences on foreign shores. However, with the onset of liberalization, Indian firms have been exposed to the full force of competitive forces from across the borders. In addition, Indian markets have also been flooded with products and service offerings from other countries. At the micro level, domestic companies have had to brace themselves for the competition from the multinationals. A concurrent development has been the signing of Free Trade Agreements (FTAs) between a number of nations. The net effect of all these developments has been the creation of a globalized integrated system across the world. A relevant question that is often raised in this connection is the degree of such integration across countries.