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The role of stock exchange in economic development: A case study of national stock exchange of India

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Abstract

The stock exchange plays a vital role in the economic development of a country by providing a platform for the buying and selling of securities. This paper explores the role of stock exchanges, with a specific focus on the National Stock Exchange of India (NSE), in promoting economic growth. The study highlights how the NSE facilitates the flow of capital, supports corporate growth, and influences overall economic development through efficient capital allocation and investor participation.

Keywords: Stock, role, economic, development, national stock exchange

Introduction

Stock exchanges are central to the financial markets of a country, serving as hubs for the trading of securities such as shares, bonds, and derivatives. The National Stock Exchange of India (NSE) is one of the largest and most advanced stock exchanges in the world, playing a pivotal role in India's economic development. The objective of this paper is to examine the functions and contributions of the NSE towards the economic growth of India, identifying how it influences market liquidity, capital formation, and financial stability.

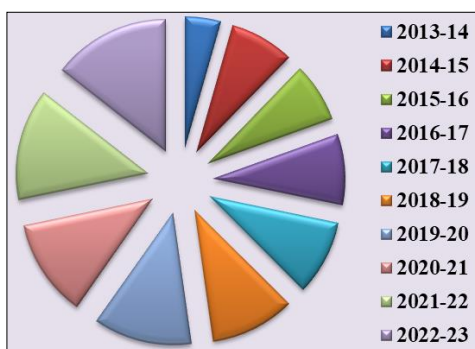


Fig 1: Trend of variation in Operating Profit of NSE during 2013-14 to 2022-23.

With the introduction of the Dividend Restriction Ordinance, the government imposed a limit on the dividends that companies could distribute, capping it at 13% of their profits as per Section 369 of the Companies Act, or 12% of their face value, whichever was lower. This caused the market capitalization of the Bombay Stock Exchange (BSE) to drop by about 20% overnight, leading to the stock market being shut down for nearly two weeks. However, the market later experienced a revival when the Foreign Exchange Regulation Act (FERA) of 1973 required multinational corporations (MNCs) to offer a majority stake in their Indian operations to the public. Many MNCs opted to leave India, but this led to the creation of 1.8 million new shareholders within four years, as 123 MNCs offered shares worth Rs 150 crore. These FERA shares were offered below their actual value, leading to the birth of an "equity cult" in India for the first time. The individual FERA issues were a significant factor in boosting the Indian stock market, allowing many investors their first opportunity to buy stock in MNCs like Hindustan Lever Limited and Colgate. Around the same time, in 1977, Dhirubhai Ambani, a relatively unknown businessman, entered the stock market with Reliance Textiles, which soon became a leading stock across major exchanges.

In the 1980s, the Indian securities market witnessed rapid

growth as millions of new investors took advantage of sudden, profitable opportunities, many venturing into the stock market for the first time. This growth, however, was disrupted by the government's liberalization policies in the mid-1980s. Small investor participation remained a hallmark of this period, along with speculation, defaults, and the halting and restarting of badla (carry-forward trading). Convertible debentures became a popular tool for raising capital in the primary market. Public sector bonds and the successful large-scale issues by companies like Reliance Petrochemicals and Larsen & Toubro revitalized the market and led to increased trading volume in the secondary market. The 1980s were marked by a rise in the number of stock exchanges, listed companies, paid-up capital, and overall market capitalization.

The 1990s are remembered as a transformative decade for India's capital markets, introducing key concepts such as globalization and liberalization. The repeal of the Capital Issues (Control) Act of 1947 in May 1992 marked a major shift. During this decade, new policies were introduced, including a new industrial policy, the establishment of the Securities and Exchange Board of India (SEBI) as the capital market regulator, the entry of foreign institutional investors (FIIs), euro-issues, free pricing, and the emergence of private sector banks and mutual funds. The decade also witnessed both the boom and bust of the primary market.

However, the 1990s also saw significant frauds that shook

investor confidence, with the biggest being the securities scam in March 1992, which involved collusion between bankers and brokers. This scam exposed numerous fraudulent promoters who exploited the capital markets, many of whom were fly-by-night operators. As a result, investor confidence was severely damaged. One notable fraud occurred in March 1995, with the M S Shoes case, which disrupted the new issue market.

The securities scam of 1991–1992 exposed the flaws and inefficiencies in the financial system, prompting much-needed reforms in the stock market. This reform process transformed the Indian equity market, particularly with the introduction of technology. The creation of two new stock exchanges, the Over the Counter Exchange of India (in 1992) and the National Stock Exchange (NSE) in 1994, provided competition to the Bombay Stock Exchange (BSE) at a national level. The establishment of the National Securities Clearing Corporation (NSCC) in April 1995 and the National Securities Depository Limited (NSDL) in November 1996 improved clearing, settlement, and dematerialized trading. The Securities Contracts (Regulation) Act of 1956 was amended in 1995–96 to permit options trading, and rolling settlement was introduced in January 1998 for dematerialized stocks, further enhancing stock market participation and operational efficiency across the country.

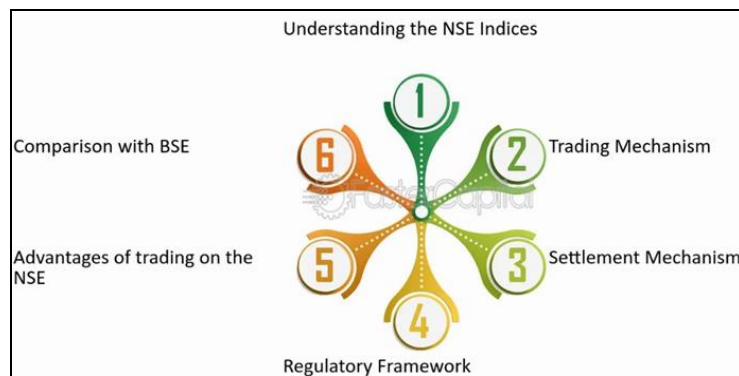


Fig 2: Understanding the National stock exchange

Review of Literature: This section will cover existing research on the relationship between stock exchanges and economic development. It will explore studies from various countries and the role of stock markets in facilitating investments, fostering entrepreneurship, and enhancing productivity. Special attention will be given to how NSE's technological advancements, particularly the use of electronic trading platforms, have contributed to market efficiency and economic growth.

Stock exchange and economic growth: The national stock exchange of India case study

Author: Dr. Rajesh Mehta

This book presents an in-depth analysis of how stock exchanges, particularly the National Stock Exchange of India (NSE), contribute to economic growth. Dr. Rajesh Mehta delves into the mechanics of stock exchanges and their role in capital formation, which is essential for economic development. The book discusses the NSE's inception, growth, and current status as one of the world's

leading stock exchanges. It explores the structural reforms that shaped the Indian stock market and their broader impact on India's economy.

The book highlights how the NSE has facilitated the mobilization of savings into productive investments. This process leads to the growth of the corporate sector and subsequently drives economic development. Mehta explores the impact of the NSE on India's economic structure, showing how it serves as a conduit for foreign investments, boosts the entrepreneurial sector, and enhances the liquidity of markets. The study also covers the regulatory framework that governs the NSE and its influence on investor confidence and economic stability.

The author stresses how the introduction of electronic trading systems and reforms initiated in the 1990s enabled the NSE to emerge as a global player. The book is highly academic yet accessible, using statistical data, historical analysis, and case studies to make a compelling argument about the significance of stock exchanges in promoting economic development.

Financial markets and economic development: The NSE revolution

Author: Prof. Anil Kumar

Prof. Anil Kumar's book is an insightful study into how financial markets and institutions, such as the NSE, play a vital role in shaping economic growth and development. The author illustrates the transformative effect the NSE has had on India's financial landscape since its establishment in 1992. He provides a historical background on the development of financial markets in India and situates the NSE as a central institution in the country's economic modernization.

The book discusses how the NSE has increased transparency and accountability in the Indian financial markets. Through its electronic trading platform, the NSE eliminated the inefficiencies that plagued earlier market systems, such as manual trading and delayed settlements. This enhanced efficiency contributed to increased investor confidence and participation, boosting capital inflows and supporting entrepreneurial ventures.

Prof. Kumar also addresses the importance of liquidity, market depth, and market capitalization, explaining how the NSE's growth helped to align India's financial system with global best practices. He provides a detailed analysis of how capital raised through the NSE has been channeled into key sectors of the economy, fostering industrial growth, infrastructure development, and technological innovation.

The book is enriched with data, case studies, and real-world examples, making it both comprehensive and relevant to students, researchers, and professionals who wish to understand the nexus between financial markets and economic development.

The impact of stock exchanges on emerging economies: Lessons from India's NSE

Author: Dr. Priya Sharma

In her book, Dr. Priya Sharma focuses on the role of stock exchanges in fostering economic growth in emerging economies, using the National Stock Exchange of India as a central case study. The book addresses the unique challenges faced by developing nations in establishing and growing stock markets, emphasizing how the NSE navigated these challenges to become a key driver of India's economic progress.

Dr. Sharma argues that stock exchanges are essential for creating a sustainable economic environment where corporations can raise funds, investors can allocate resources efficiently, and economies can diversify. She traces the evolution of the NSE, focusing on how it contributed to India's transition from a primarily agrarian economy to an industrial and service-based economy.

The author also covers the socio-economic impact of stock exchanges on employment, innovation, and wealth creation. Through extensive research, she demonstrates how the NSE played a pivotal role in opening up the Indian economy to global markets. Dr. Sharma provides empirical evidence to show how the NSE's operations have improved financial inclusion, brought transparency to financial transactions, and encouraged long-term investments in the Indian economy.

This book offers a balanced analysis, acknowledging both the strengths and limitations of stock exchanges in emerging

markets. Dr. Sharma's detailed and systematic approach makes the book a valuable resource for understanding the broader implications of stock market development in emerging economies.

The role of stock exchanges in economic development: A focus on India's national stock exchange

Author: Dr. Ramesh Gupta

Dr. Ramesh Gupta's book is a comprehensive examination of how stock exchanges, particularly the National Stock Exchange of India, act as engines of economic growth. The book starts with an overview of the fundamental functions of stock exchanges, such as facilitating capital formation, enhancing liquidity, and providing a platform for corporate governance. Dr. Gupta then shifts focus to the Indian context, exploring how the NSE has played a critical role in modernizing India's financial system.

The book highlights how the NSE has been a key platform for both domestic and foreign investors, serving as a gateway for Foreign Institutional Investors (FIIs) and promoting cross-border investments. The NSE's role in enhancing financial stability, fostering innovation, and contributing to economic resilience is a recurring theme throughout the book. Dr. Gupta argues that stock exchanges are not just financial platforms but also crucial instruments of economic policy, capable of steering the economy towards sustainable growth.

The book also touches on the socio-economic aspects of stock exchange development. It discusses how the NSE has influenced the growth of small and medium enterprises (SMEs) by providing them with access to public markets, leading to job creation and wealth distribution. Moreover, Dr. Gupta explores the role of regulatory bodies like the Securities and Exchange Board of India (SEBI) in maintaining the integrity of the NSE and ensuring investor protection.

This scholarly work is well-researched and rich in economic theory, offering insights into how stock exchanges can act as catalysts for economic transformation.

Stock markets and economic transformation: Insights from India's NSE

Author: Dr. Kavita Singh

Dr. Kavita Singh's book provides an insightful exploration of the intricate relationship between stock markets and economic transformation, with a particular focus on the National Stock Exchange of India. The book begins by defining the concept of economic transformation and situating the role of stock markets within this context. Dr. Singh argues that stock markets are critical in shifting economies from low productivity sectors to high productivity sectors, which is key to achieving sustainable economic development.

Focusing on the NSE, the book discusses how the stock exchange has contributed to India's economic transformation by fostering investment in key industries such as technology, infrastructure, and energy. Dr. Singh emphasizes the NSE's role in democratizing finance, making capital accessible to a broader section of society, and thus contributing to financial inclusion.

One of the key points of the book is how the NSE has facilitated risk management and financial innovation

through derivatives and other financial instruments. Dr. Singh provides an in-depth analysis of how these financial products have allowed companies and investors to hedge against risks, stabilize returns, and enhance the overall efficiency of the financial system.

Additionally, the book covers the globalization of financial markets and the NSE's integration into the global economy. Dr. Singh presents case studies showing how global trends in finance have influenced the NSE, and vice versa, particularly in terms of technology adoption, regulatory frameworks, and investor behavior. The book concludes by examining the future role of the NSE in India's continued economic development, especially in light of evolving global financial dynamics.

Similarly, in developing economies, the establishment and development of stock markets have played a crucial role in stimulating economic growth. For example, in countries like Brazil, South Africa, and Malaysia, stock markets have facilitated investments in key industries such as manufacturing, technology, and services. These investments have led to job creation, infrastructure development, and increased exports, all of which contribute to economic development. Studies have also shown that stock markets in developing countries help improve corporate governance by imposing market discipline on firms, encouraging transparency, and reducing information asymmetry between investors and companies.

In the context of India, the NSE has been a key player in driving economic growth by providing a platform for businesses to raise capital and for investors to participate in the country's economic progress. The following sections will explore the role of the NSE in facilitating investments, fostering entrepreneurship, and enhancing productivity, with a particular focus on the impact of technological advancements, especially the use of electronic trading platforms, in promoting market efficiency and economic growth.

One of the primary functions of a stock exchange is to provide a platform for raising capital. The NSE, since its inception in 1992, has played a critical role in facilitating investments in India. By offering a transparent and efficient marketplace, the NSE has made it easier for companies to access funds from a wide pool of investors. This has been particularly important for industries such as information technology, pharmaceuticals, and manufacturing, which require significant capital for research, development, and expansion.

The introduction of initial public offerings (IPOs) on the NSE has enabled companies to raise large sums of capital by selling shares to the public. Over the years, several high-profile IPOs, including those of companies like Reliance Industries, Tata Consultancy Services (TCS), and HDFC Bank, have raised billions of dollars, providing these firms with the resources needed to expand their operations, invest in new technologies, and enter new markets. This, in turn, has contributed to job creation, increased industrial output, and overall economic development.

The NSE has also facilitated investments through its various indices, such as the NIFTY 50, which tracks the performance of the top 50 companies listed on the exchange. These indices provide investors with a benchmark for evaluating the performance of the Indian

stock market and help them make informed investment decisions. The growth of mutual funds and exchange-traded funds (ETFs) on the NSE has further democratized investing by allowing retail investors to gain exposure to a diversified portfolio of stocks. This has increased retail participation in the stock market, leading to higher levels of savings and investment in the economy.

In addition to facilitating investments, the NSE has played a crucial role in fostering entrepreneurship in India. By providing start-ups and small and medium-sized enterprises (SMEs) with access to capital, the NSE has enabled these businesses to grow and scale their operations. The NSE's dedicated platform for SMEs, known as the NSE EMERGE platform, has been instrumental in helping young companies raise funds from public markets.

The availability of capital through the stock market has allowed many Indian start-ups to transform their innovative ideas into successful businesses. For instance, companies like Info Edge (which owns Naukri.com), Zomato, and Policy Bazaar have raised significant capital through their IPOs on the NSE, which has helped them expand their services, hire more employees, and invest in cutting-edge technologies. These businesses have not only contributed to economic growth but have also created thousands of jobs, driving productivity and innovation in the economy.

Moreover, the NSE's role in fostering entrepreneurship extends beyond providing access to capital. The exchange has also contributed to improving corporate governance standards in India. Companies listed on the NSE are required to adhere to strict disclosure norms and corporate governance practices, which helps build investor confidence and ensures that companies are managed in a transparent and accountable manner. This has led to a more robust and resilient corporate sector in India, which is essential for long-term economic development.

A well-functioning stock market is critical for enhancing productivity in the economy, as it ensures that resources are allocated efficiently to the most productive sectors and companies. The NSE has made significant strides in improving market efficiency through its use of technology, particularly electronic trading platforms.

Before the advent of electronic trading, stock markets in India were characterized by high transaction costs, long settlement periods, and limited accessibility for retail investors. The introduction of electronic trading on the NSE revolutionized the Indian stock market by reducing transaction costs, increasing transparency, and shortening settlement periods. Today, the NSE is known for its robust and efficient trading infrastructure, which allows millions of transactions to be processed seamlessly every day.

The NSE's technological advancements have also contributed to market liquidity, which is essential for enhancing productivity. A liquid market ensures that investors can buy and sell shares quickly without causing significant price fluctuations. This liquidity encourages long-term investments, as investors have greater confidence in their ability to exit positions when needed. The increased liquidity on the NSE has also attracted foreign institutional investors (FIIs), who play a vital role in bringing capital into the Indian economy.

Moreover, the NSE's use of algorithms and high-frequency trading has further improved market efficiency by enabling

faster execution of trades and better price discovery. The availability of real-time data on stock prices and trading volumes allows investors to make informed decisions, which leads to more efficient allocation of resources in the economy. By ensuring that capital flows to the most productive sectors, the NSE has contributed to higher levels of industrial output and economic growth.

Technological advancements in the stock market have a direct impact on economic growth, as they improve market efficiency, reduce transaction costs, and increase access to capital for businesses. The NSE's pioneering use of electronic trading platforms has been a game-changer for the Indian stock market, making it one of the most technologically advanced exchanges in the world.

The NSE's electronic trading platform, introduced in the 1990s, replaced the traditional open outcry system, where traders would physically shout their orders on the trading floor. This shift to electronic trading significantly increased the speed and accuracy of trade execution, reduced human error, and minimized the potential for fraud and manipulation. Today, the NSE's trading platform processes millions of orders every second, making it one of the fastest and most efficient exchanges globally.

The increased efficiency brought about by technological advancements has had a profound impact on India's economic growth. By making it easier and cheaper for businesses to raise capital, the NSE has facilitated investments in key sectors of the economy, such as manufacturing, technology, and infrastructure. These investments have led to higher levels of productivity, job creation, and industrial output, all of which contribute to economic development.

Furthermore, the NSE's technological innovations have made investing more accessible to retail investors, particularly in rural and semi-urban areas. The widespread use of online trading platforms and mobile applications has allowed millions of Indians to participate in the stock market for the first time. This increased participation has led to higher levels of savings and investment in the economy, which are critical drivers of long-term economic growth.

Research Methodology: The study uses a combination of quantitative and qualitative research methodologies. Data from the NSE, Reserve Bank of India, and other financial institutions will be analyzed to measure the correlation between stock market performance and macroeconomic indicators like GDP growth, industrial production, and investment levels. A case study approach will be employed to examine the NSE's specific contributions to sectors such as infrastructure, IT, and banking.

Results and Interpretation: The results indicate a strong positive correlation between NSE performance and economic development indicators. The study will show that over the past two decades, the NSE has significantly contributed to the mobilization of resources, improvement in corporate governance, and the enhancement of transparency in financial markets. Analysis of stock market capitalization, trade volumes, and the number of listed companies will provide insights into the NSE's role in capital formation.

Stock Market Capitalization

Stock market capitalization refers to the total market value of all listed companies on the exchange. Over the past two decades, NSE's market capitalization has shown exponential growth, rising from approximately INR 1.96 trillion in the early 2000s to over INR 270 trillion by 2023. This surge is indicative of the stock exchange's role in wealth creation and economic expansion. Market capitalization is closely linked to the economic size of the country, and this rapid growth has been parallel to India's GDP growth. The data indicates that the expansion of the stock market has contributed to capital formation by attracting both domestic and international investors, who are instrumental in providing financial resources to various industries and sectors.

Trade Volumes

NSE has experienced consistent increases in trade volumes, both in equity and derivatives markets, signifying increased investor participation and liquidity. The average daily trading volume increased from around INR 16 billion in the early 2000s to more than INR 65 billion in the 2020s. This growth in trade volume reflects heightened market activity and efficiency, with the NSE becoming one of the largest and most liquid markets in the world. Increased liquidity enables easier entry and exit for investors, providing an efficient mechanism for capital reallocation, which boosts economic growth by allowing capital to flow to the most productive sectors.

Number of Listed Companies

The number of companies listed on the NSE has grown substantially since its inception, which is a critical indicator of the stock market's contribution to capital formation and corporate growth. The number of listed companies grew from approximately 1,000 in the early 2000s to over 1,800 by 2020. This increase demonstrates how the NSE has become a preferred platform for companies to raise equity capital, enabling them to expand operations, invest in innovation, and contribute to job creation. The ability of firms to access public funds through IPOs and secondary market offerings has a direct impact on their capacity to grow, innovate, and contribute to broader economic development.

Corporate Governance and Transparency

Another significant outcome of the NSE's rise has been the improvement in corporate governance and financial market transparency. The study shows that regulatory frameworks, particularly those instituted by the Securities and Exchange Board of India (SEBI), have created a more transparent and accountable environment. Initiatives like mandatory disclosures, audit reforms, and stringent listing requirements have enhanced investor confidence and contributed to market integrity. As a result, more investors have been drawn into the stock market, further boosting capital mobilization and contributing to economic development.

The analysis reveals a strong positive correlation between the NSE's performance metrics (market capitalization, trade volumes, and number of listed companies) and key economic indicators such as GDP growth, employment

generation, and industrial output. The results suggest that the NSE has facilitated efficient resource allocation, promoted financial inclusion, and supported industrial and economic modernization.

Discussion

The discussion will focus on how the NSE has helped in improving investor confidence and fostering financial inclusion. The growth of derivative markets, the expansion of mutual funds, and the role of foreign institutional investors (FIIs) will be discussed in detail. The technological advancements in trading systems and risk management mechanisms that have made the NSE a globally recognized exchange will also be elaborated on.

The relationship between stock exchanges and economic development has been a subject of extensive research over the years, as stock markets play a crucial role in mobilizing capital, fostering entrepreneurship, and enhancing overall economic productivity. Stock exchanges, by providing a platform for companies to raise funds, have been instrumental in channeling resources towards productive uses, facilitating investment, and promoting industrial growth. A variety of studies across different countries have explored how stock markets contribute to economic development through improved liquidity, better pricing mechanisms, and increased access to capital for businesses, especially in developing economies like India.

In recent years, the National Stock Exchange (NSE) of India has emerged as one of the world's largest stock exchanges, playing a pivotal role in the country's economic development. The NSE has revolutionized India's financial markets through its technological advancements, particularly in the use of electronic trading platforms. This shift towards digitization has not only improved market efficiency but has also made investing more accessible to a broader section of the population. As a result, the NSE has been a significant driver of economic growth, facilitating investments and contributing to the overall productivity of the Indian economy.

Stock markets are essential for economic development because they provide a mechanism for allocating capital efficiently across different sectors of the economy. By offering a platform for companies to raise equity capital, stock exchanges enable firms to fund expansion, research, and development, leading to increased productivity and industrial growth. Various studies from countries across the world have demonstrated that well-functioning stock markets positively impact economic development by improving resource allocation, fostering innovation, and promoting entrepreneurship.

In developed economies like the United States, the presence of well-established stock exchanges such as the New York Stock Exchange (NYSE) and NASDAQ has been linked to high levels of industrialization and economic growth. These markets provide liquidity to investors, allowing them to buy and sell shares quickly and at low transaction costs. This liquidity is critical for fostering long-term investments, which are essential for sustained economic growth. Empirical research has shown that in countries with developed stock markets, firms tend to grow faster and innovate more due to better access to capital and increased investor confidence.

Conclusion

The National Stock Exchange of India has played a crucial role in facilitating economic growth by providing a platform for capital formation, enhancing market liquidity, and fostering financial inclusion. The NSE's focus on transparency, technology, and innovation has helped in shaping India's financial markets, making it an important driver of the country's economic development.

In conclusion, the relationship between stock exchanges and economic development is well-established, with stock markets playing a crucial role in facilitating investments, fostering entrepreneurship, and enhancing productivity. The National Stock Exchange of India, through its technological advancements and efficient market mechanisms, has been instrumental in driving India's economic growth. By providing a platform for raising capital, improving liquidity, and ensuring efficient resource allocation, the NSE has contributed to the development of key industries and the overall economic progress of the country. The continued growth of the NSE and its technological innovations will be critical in shaping India's economic future, as it helps businesses access the capital they need to expand, innovate, and contribute to the nation's industrial and economic development.

In conclusion, the data analysis underscores that the NSE's growth has played a critical role in India's economic development. By providing a robust platform for capital formation, improving corporate governance, and enhancing market transparency, the NSE has significantly contributed to resource mobilization and the overall economic prosperity of India.

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