Quest Journals
Journal of Research in Business and Management
Volume 12 ~ Issue 4 (2024) pp: 41-51
ISSN(Online):2347-3002
www.questjournals.org

Research Paper

Evolution of the Capital Market

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Abstract:
This paper explores the evolution of the capital market, beginning with the conceptualization of capital formation and its crucial role in economic development. It emphasizes the importance of sensitising the public to not only save but also invest unutilised funds. It discusses how the primary capital market pools funds through intermediaries, facilitating investment in entrepreneurial ventures.
The paper outlines the significance of the secondary capital market, particularly the stock market, as a platform for trading financial instruments and providing liquidity to investors. Tracing the origin of the capital market, it highlights the role of early merchants as lenders and the evolution of trading systems for debts.
Further, it examines early regulatory efforts by governments, including statutory requirements for incorporating associations into companies, and the development of principles such as separation of ownership from management and limited liability. Finally, it discusses legislative measures to protect investors from fraudulent practices and modern government initiatives to promote investment through predictable fiscal policies.
Keywords: *capital market, primary market, stock market, funds, traders, intermediaries, securities, company, regulation*

Received 28 Mar., 2024; Revised 05 Apr., 2024; Accepted 07 Apr., 2024 © The author(s) 2024.
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I. Introduction

This paper interrogates the evolution of the capital market. The researcher commences by conceptualising capital formation and underlines its critical role in the development of a State's economy. As it will be discussed, central to capital formation, is the stimulation or incentivising of the public to save funds. Thereafter, a portion of this paper dwells on the immense role of the primary capital market in pooling unutilised small or scattered units of unutilised funds through intermediaries such as brokers and investment banks and how it provides pivotal linkage with potential entrepreneurs whether individuals or corporations. In doing so, this paper details how the entrepreneurs sourcing capital from the public through the market regulator provide financial instruments to each subscriber as assets representing their interest in the enterprise they have invested in.

Moreover, this paper elaborates on the significance of the secondary capital market that is commonly known as the stock market. This discussion will dwell on how the stock market provides stakeholders a platform to trade financial instruments and its significance in providing investors an avenue to liquidate their assets. In attempting to unearth the evolution of the capital market, the researcher of this paper traces the origin of the capital market by establishing how earlier merchants acted as lenders and systems where debts were traded. Along this line, this paper outlines world's premier stock market where after long time of traders conducting their business separately, were brought together under one house and the implications thereof.

Most importantly, this paper traces the initial attempts to regulate the capital market by governments. At the heart of these initial regulatory efforts is the statutory requirement incorporate associations into companies. Subsequently, principles of separation of ownership from management and limited liability were evolved which made the company a more efficient platform for sourcing capital from the public and conducting enterprise. Along this line, this researcher details how the prospective investors were duped by fraudulent promoters and the corrective legislative efforts made to protect the public from such fraudulent practices. Drawing from the lessons learnt in the past, the final part of this discussion elaborates the efforts made by

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modern governments to promote both local and foreign direct investment in the capital market by providing a thriving environment through well thought and predictable fiscal policies.

II. Conceptualising the Capital Market

2.1 Capital Formation

There are various levels of development of a country's economy. One such level is where, the expenditure is higher than the income. Here little amount of money is saved implying that there exists a vicious cycle of poverty as is opined by Nurkse; "the vicious cycle of poverty implies circular constellation of forces to act and react one another in such a way as to keep a poor country in a state of poverty."[2]

Therefore, to develop a country, a policy that stimulates saving of funds amongst citizens is essential. To boost savings, citizens are encouraged to deposit their small surplus funds in financial institutions such as banks, co-operative societies, building societies, mutual funds, stockbrokers and pension funds for a specified period of time at fixed rate of interest without withdrawal. The savings now become investments.

After a period of time, the culture of saving is instilled in the public. The financial institutions stated above therefore play a vital role in the economic development of the country. Through various incentives they pool together small, unused, surplus savings from individuals, households and groups scattered throughout a wide geographical area.

Upon gaining access to the surplus unutilised funds, the financial institutions transfer funds into deficit units. These institutions therefore act as a link between those that have unused surplus savings with potential entrepreneurs who are in search of funds to fund their ideas. As aptly described by Schumpeter, "without the transfer of purchasing power to him, a concept creator cannot become the entrepreneur."[3]

2.2 Meaning of Capital Market

Drawing from the above discussion, a capital market in simple terms may be a place, physical or virtual where investors through financial intermediaries lend funds for a fixed long term to borrowers in exchange for financial assets. The maturity period of the financial assets is above a period of one year in addition to interest accruing thereof. The demand for funds mainly comes from the government (national, devolved and local), individuals who seek funds to put into action their entrepreneurial skills, private and public corporations seeking to expand their production. In order to raise long term funds, the borrowers issue shares, long term bonds, debentures and other securities.

"A capital market is a platform where buyers and sellers engage in trade of financial securities like bonds, stocks, among others. The buying or selling is undertaken by participants such as individuals and institutions. Capital markets help channel surplus funds from savers to institutions which then invest them into productive use. Generally, this market trades mostly in long-term securities."[4] It is a financial market in which long-term debt (over a year) or equity-backed securities are bought and sold.[5]

It can be either a primary market or a secondary market. In primary market, new stock or bond issues are sold to investors, often via a mechanism known as underwriting. The main entities seeking to raise long-term funds on the primary capital markets are governments (which may be municipal, local or national) and business enterprises (companies). Governments issue only bonds, whereas companies often issue both equity and bonds. The main entities purchasing the bonds or stock include pension funds, hedge funds, sovereign wealth funds, and less commonly wealthy individuals and investment banks trading on their own behalf. In the secondary market, existing securities are sold and bought among investors or traders, usually on an exchange, over-the-counter, or elsewhere. The existence of secondary markets increases the confidence of potential investors to channel their unutilised savings in primary markets, as they know they will have an avenue to promptly liquidate their investments whenever they wish without complexities.[6]

It is of paramount importance to note that the capital market is wide and it is either organised or unorganised. The organised capital market has an authority which regulates market stakeholders and has a laid

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[2] Rahman Habibur. "Nurkse on Problems of Capital Formation in Under-developed Countries—A Critique." *The Punjab University Economist*, vol. 2.4 (1961): pp.1-23.

[3] Schumpeter Joseph A and Richard Swedberg. *The Theory of Economic Development,* (Routledge, 2021).*See also* Vaz-Curado, Samuel Fernandes Lucena and Antony Peter Mueller. "The Concept of Entrepreneur of Schumpeter in Comparison to Kirzner." MISES: *Interdisciplinary Journal of Philosophy, Law and Economics*, vol.7.3 (2019).

[4] The Economic Times, 'Capital Market', obtained from <https://economictimes.indiatimes.com/definition/capital-market> accessed 17 October 2018.

[5] Arthur O'Sullivan and Steven M. Sheffrin, *Economics: Principles in Action,* (Prentice Hall, 2003).

[6] Michael P McLindon, *Privatization and Capital Market Development: Strategies to Promote Economic Growth* (Bloomsbury Academic, 1996).

down framework that controls the on goings in the capital market. The unorganised capital market consists of traditional lenders especially in rural areas who lend funds for a long term at an agreed interest rate.[7]

In socialist economies like India where the government actively participates in establishing economic development priorities, there exist development banks as part of the capital market. The role of development banks is to act as an avenue to stimulate growth of priority sectors of the economy. For instance, since 1964, the Industrial bank of India (IDBI) provides capital to those enterprises seeking to build industries. The National Bank for Agriculture and Rural Development (NABARD) was established in 1982 with a deliberate aim of developing rural areas and to spur the agricultural sector.[8]

The African Development Bank Group (AfDB) or Banque Africaine de Développement (BAD) was established in 1972 with a mandate to spur projects which shall stimulate economic development. It lends funds to governmental institutions for a long term for the purposes of stimulating infrastructural development.[9]

2.3 Significance of the Capital Market in Economic Development

The Capital market plays a critical role in economic development of a country by providing a regulated platform through which financial intermediaries pooling small units of unutilised savings into large sum of funds which are then availed to borrowers who need capital to further their enterprise. Therefore, this market is an avenue where funds which had been lying unutilised, are pooled together by intermediaries and lent at a specified interest for a long term period above one year to borrowers who intend to use them to generate more revenue. In the long run the public is encouraged to save and invest more.[10]

Thus the entrepreneur accesses funds that he seeks in exchange for a financial asset. The investor earns interest (dividends) on the amount of savings he deposited and financial institutions acting as intermediaries provide a source of employment for citizens skilled in various competencies concerning finance, law, economy and investment. Above all, the capital market stimulates economic growth of a country hence it is the reason why most modern day governments keep a keen eye on the capital markets, monitor reactions to governmental policies, study effects any governmental action would have on the capital markets before it is implemented. In conclusion the capital market lies at the heart of economic development of any country and it is prudent for the government to come up with deliberate policies which ensure the establishment of a stable and functioning capital market.[11]

2.4 Diverse Securities Traded in the Capital Market

There are various financial instruments that are traded in the capital market; one of the most commonly traded instruments is a share. It is an indivisible unit of capital, expressing the ownership relationship between the company and the shareholder. The denominated value of a share is its face value, and the total of the face value of issued shares represent the capital of a company. It is interest measured by sum of money and made up of diverse rights conferred on its holders by the articles of the company which constitute a contract between him and the company.[12] It can also mean the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and the interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se accordance with the legal framework for corporations or companies.[13]

Another instrument traded in the capital market is a debenture whose meaning is a type of debt instrument that is not secured by physical assets or collateral. Debentures are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond to secure capital. Like other types of bonds, debentures are documented in an indenture.[14] On the other hand, a bill which is another instrument is a document evidencing one party's indebtedness to another, such as an invoice.[15]A bond is a debt security, under which the issuer owes the holders a debt and (depending on the

[7]National Securities Depository Limited (NSDL), 'Capital Markets and NSDL Overview', obtained from <https://nsdl.co.in/downloadables/pdf/capital-markets-and-nsdl-overview.pdf> accessed on 18/10/18

[8] Muhammad Shafi K, "Impact of Financial Sector Reforms on Indian Development Banking", (PhD thesis, Department of Commerce, Aligarh Muslim University, 2008).

[9] Will Kenton, "African Development Bank (ADB)", Investopedia, obtained from <https://www.investopedia.com/terms/a/african-development-bank.asp> accessed on 25 October 2018.

[10] Soyode Afolabi,"The Role of Capital Market in Economic Development", *Security Market Journal in Nigeria,* vol. 6.2 (1990), pp. 321-336.

[11] Nazir Mian Sajid, Muhammad Musarat Nawaz and Usman Javed Gilani, "Relationship between Economic Growth and Stock Market Development", *African Journal of Business Management,* vol. 4.16 (2010), pp.3473.

[12] *CIT v. Standard Vacuum Oil Co.* (1996) Comp. LJ 187 (SC).

[13]*Borland's Trustee v Steel Brothers & Co Ltd* (1901) 1 Ch 279 *R.T. Perumal v. John Deavin* AIR 1960 MADRAS 43.

[14]James Chen, "Debenture Explained, With Types and Features", *Investopedia,* obtained from <https://www.investopedia.com/terms/d/debenture.asp> accessed on 23 October 2018.

[15]Business Dictionary, "Bill" <https://www.businessdictionary.com/definition/bill> accessed on 23 October 2018.

terms of the bond) is obliged to pay them interest (the coupon) or to repay the principal at a later date, termed the maturity date.[16]

A future is "a binding contract made on the trading floor of a futures exchange to buy or sell a commodity, financial instrument, or security, on a stated future date at a specified price. These agreements are standardized in terms of quantity, quality, delivery location, and delivery time for each item, and do not normally result in an actual delivery but are settled (traded out) through counter-contracts. Used in hedging, futures contracts help mitigate the risk of wild price fluctuations. In contrast to an option (right to buy or sell an item that lapses if not exercised) a futures contract is an obligation fulfilled only by the completion of the transaction."[17]

Additionally, "options are contracts through which a seller gives a buyer the right, but not the obligation, to buy or sell a specified number of shares at a predetermined price within a set time period."[18] Mortgage-backed securities entail investments that are secured by mortgages. They are a type of asset-backed security. A security is an investment that is traded on a secondary market. It allows investors to benefit from the mortgage business without ever having to buy or sell an actual home loan. Typical buyers of these securities include institutional, corporate or individual investors.[19]Similarly, a mutual fund is a professionally-managed investment scheme, usually run by an asset management company that brings together a group of people and invests their money in stocks, bonds and other securities.[20] Finally, equity is "a stock or any other security representing an ownership interest. This may be in a private company, in which case it is a private equity." [21]

III. Classification of the Capital Market

3.1 Primary Capital Market

The capital market consists of the primary and the secondary market. The primary capital market is also known as the new issue market and in simple terms this is where securities are issued for the first time. This market is dominated mainly by companies whether public or private seeking additional funds to kick start a new enterprise or seeking to expand its existing enterprise. To raise such funds, the company issues securities such as shares, bonds, debentures to investors in exchange of their savings. The price of each security is set beforehand in consultation with the market regulator.[22]

3.2 Raising Funds in the Primary Capital Market

(i) (IPO) Initial Public Offer

The company through an advert, invites investors from the general public. The advert contains the prospectus of the company. The prospectus provides critical information for the prospective investor such as background of the company, the number of shares on sale, the price of each share, and the maximum number of shares an individual can buy, where to buy the shares from, the opening date of the initial public offer and the last date of the initial public offer.

After the advert, the general public subscribes to the securities. Thereafter, the securities are allotted to the public. In case the number of subscribers are more than the number of shares, then the shares are allotted through lottery or prorate basis.

The company issuing an initial public offer of shares or any other form of securities in most cases hires stock brokers, merchant banks or underwriters to enable it issue its securities without a glitch within an assigned period of time and according to guidelines set by the regulatory authority of the capital market.[23]

(ii) Restricted Offer

An Initial Public Offer is an expensive affair. For a successful sale of shares the company needs funds to advertise the initial public offer extensively throughout the country, through television, radio and newspaper. Further a company has to enlist the services of stock brokers, merchant banks, financial experts and lawyers to ensure any issues or complaints are dealt with conclusively.

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[16] Arthur O'Sullivan and Steven M. Sheffrin, *Economics: Principles in Action,* (Prentice Hall, 2003).
[17] Business Dictionary, "Futures", obtained from <https://www.bussinessdictionary.com/definition/futures-contract> accessed on 23 October 2018.
[18] Nasdaq, "Options Defined", obtained from <https://www.nasdaq.com/articles/options-defined> accessed on 23 October 2018.
[19] Kimberly Amadeo, "What Are Mortgage-Backed Securities?", *The Balance,* obtained from <https://www.thebalancemoney.com/mortgage-backed-securities-types-how-they-work-3305947> accessed on 02 April 2024.
[20]The Economic Times, "Mutual Fund", obtained from <https://economictimes.indiatimes.com/definition/mutual-fund> accessed on 25 October 2018.
[21]Jason Fernando, "Equity Definition: What it is, How It Works and How to Calculate It", *Investopedia*, obtained from <https://www.investopedia.com/terms/e/equity.asp#ixzz5TWCNCWl9> accessed on 02 April 2024.
[22] Corporate Finance Institute, "Primary Market", obtained from <https://corporatefinanceinstitute.com/resources/career-map/sell-side/capital-markets/primary-market> accessed on 25 October 2018.
[23]Balkrishna Ramchandra Parab, "Initial Public Offering IPO Performance Evaluation", (PhD thesis, Jamnalal Bajaj Institute of Management Studies, Department of Management Studies, University of Mumbai, 2019).

With this in mind, to some companies, the initial public offer may be an uneconomical and tedious exercise because they may not have the funds to foot the cost of such an expensive exercise or some companies need additional funds quickly.
Therefore, they will contact banks, insurance companies, wealthy individuals and financial institutions. The company will offer them an opportunity to buy the company's security in exchange for funds. In simple terms the company will be offering an opportunity to invest to a restricted number of individuals with an aim of ensuring economy and swiftness.[24]

(iii) Rights Issue

In most cases, before opening up to the public, companies give a priority to their members. Hence an opportunity is given to their current shareholders to invest further in the company. This is based on the general concept that current investors are likely to further their interest in the company should they be given an opportunity to do so. They are given the right to buy new shares of the company but if they forfeit or fail to buy then the public is given an opportunity to buy the new shares in an initial public offer. In conclusion in the case of a rights issue, a company seeking additional funds to commence a new enterprise or seeking to expand its existing enterprise gives priority to its existing shareholders to buy new shares before venturing to the general public in an initial public offer.[25]

(iv) Electronic-Initial Public Offer

The capital market in most countries has evolved to keep in tune with the ever-changing times. Moreover, in the digital age where there are technological inventions all over the world, the capital market has made use of such inventions to promote efficiency and to avoid waste of time and resources. Therefore, the electronic initial public offer is an example of modern day advancement in the capital market. With advancement in technology a company intending to give an initial public offer of its securities may do so online. The procedure is laid out by the relevant regulatory authority. At first the company and the relevant stock exchange come to a formal agreement on how the exercise will occur. The company then hires stockbrokers to accept received applications and then it also appoints a registrar to the issue.[26]

3.3 Secondary Capital Market

It is commonly known as the stock market, here the securities of a company are traded. Investors sell the securities they already own to prospective buyers at a price determined by demand and supply forces. If there is more demand than supply for the securities of a certain company, the price of each share of the securities appreciates but if the demand for the securities is lower than the number of securities available for sale then the price of the securities falls. Therefore, the price fluctuates in obedience to the law of demand and supply. The securities traded here are mainly; shares, debentures, bonds, bills, futures, options, mutual funds and mortgage securities.

The securities are traded on the floor of the stock market through stock brokers or the traders themselves. In the modern age, with digital advancement, the stock market has been revolutionised in many ways for instance;

The real time fluctuation of prices of securities is displayed on an electronic board in the stock market.

In addition to that traders no longer need to be at the stock exchange to transact their stocks but can buy or sale in the confines of their houses or offices as long as they are virtually connected to the stock market headquarters through the internet, satellite or any other means.

With the technological advancement in the stock market, one can trade in the stock market from any part of the world as long as he is connected to the internet. Interestingly though technological advancement has made trading efficient and turned the world to a global village, the stock market is easily vulnerable to any negative effects from any part of the world such as political instability such as coups, civil wars and insurgency, inflation and disasters.

The secondary market plays a critical role in economy because it offers liquidity in the market. Had it not been present the investors would have to wait for many years to cash in their securities. However, the secondary market comes to their aid by providing an avenue for investors to sell the securities they already own to prospective investors in exchange of money. Thus the secondary market plays a critical role of promoting liquidity in an economy. Without it there would be little amount of money in circulation. In the secondary

[24] Karan Kakkar, "Private Placement V/S Preferential Allotment", *Tax Guru*, obtained from <https://taxguru.in/company-law/private-placement-v-s-preferential-allotment.html> accessed on 02 April 2024.
[25] CS Kundan Kumar Mishra, "Right Issue of Shares For Private & Public Unlisted Companies -Companies Act, 2013- Sec-62", *TaxGuru* (2 November 2014) , obtained from <https://taxguru.in/company-law/issue-shares-private-public-unlisted-companies-companies-act-2013-sec62.html> accessed on 25 October 2018.
[26] Kandpal Vinay, "Capital Market", *Journal of Internet Banking and Commerce,* vol. 26.2 (2021), pp. 1-2.

market therefore, securities change hands from the existing investor to the prospective buyer in exchange for money at a price determined by the demand and supply securities of a specific companies. This transaction occurs when the investor is in need of funds or he thinks that the current price of the security is at its peak and it's time to sell his securities especially in the moment when the demand for securities in the company that he had invested in is so high that it has triggered a drastic increase in the price of the security.[27]

IV. Evolution of the Capital Market

4.1 Origins of Capital Market Practices: Historical Perspectives on Debt Trading and Lending

In the earlier times, merchants acted as lenders of money to various businesses. Perhaps it was in the habit of lending that led to a system of trading debts. Rudimentary activities similar to those of the capital market can be traced to several centuries ago when money traders borrowed funds from individual lenders, they would then utilise these funds to propel their enterprises. Shakespeare's play, the Merchant of Venice, provides a depiction of a historical setting where traders relied on lenders to provide them with capital to fund their businesses.[28]

Apart from Venice, other parts of Europe too had a system in place where debts were traded for instance in France:

"In the 1100s, for example, France had a system where courretiers de change managed agricultural debts throughout the country on behalf of banks. This can be seen as the first major example of brokerage because the men effectively traded debts."[29]Hence the first brokers in the history of the capital market were the courretiers from France. The trading in debts perhaps initiated thoughts of coming up with negotiable instruments such as debentures.

As it appears, the absence of proper mechanisms for obtaining debts made banks in the 1300's to be reluctant to lend. This was the case especially in high risk debts as banks couldn't lend to high risk debtors. This led to a high demand for capital and therefore the lenders at that time came in to fill the demand gap. They traded with the high risk debtors by lending money to them. The money lenders took a leap of faith and begun trading in government securities. The merchants of Venice were the pioneers of trading government securities, their activities inspiring others to enter the market. Subsequently, banks from neighbouring cities like Florence, Genoa, Pisa, and Verona followed suit, engaging in government securities trading.[30]

"The money lenders of Europe filled important gaps left by the larger banks. Moneylenders traded debts between each other; a lender looking to unload a high-risk, high-interest loan exchanged it for a different loan with another lender. These lenders also bought government debt issues. As their business evolved, the lenders began to sell debt issues to customers; the first individual investors. In the 1300's, the Venetians were the leaders in the field and the first to start trading securities from other governments. They would carry slates with information on the various issues for sale and meet with clients, much like a broker does today."[31]

4.2 The world's Premier Stock Market

The origins of the first stock markets are believed to trace back to Belgium and Dutch cities such as Bruges, Flanders, Ghent, and Rotterdam. Significant developments in the capital market occurred during the 13th century when influential traders like Van der Beurze conducted transactions resembling those of a stock market from his house. No doubt at the initial stages, there wasn't similar infrastructural and institutional capacity compared to the modern stock market, further, with the absence of listing of companies at the stock market, there was no trading in shares of companies, instead, the markets primarily focused on trading government securities and individual debts.[32]

"A common belief is that in late 13th century Bruges commodity traders gathered inside the house of a man called Van der Beurze, and in 1309 they became the "Brugse Beurse", institutionalising what had been, until then, an informal meeting, but actually, the family Van der Beurze had a building in Antwerp where those gatherings occurred. The Van der Beurze had Antwerp, as most of the merchants of that period, as their primary place for trading."[33]

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[27] David M. Arseneau, David E. Rappoport and Alexandros Vardoulakis, "Secondary Market Liquidity and the Optimal Capital Structure," *FEDS Working Paper,* no. 2015-031 (Board of Governors of the Federal Reserve System, 2015).
[28]William Shakespeare and Cedric Watts (ed), *The Merchant of Venice* (Ware: Wordsworth Editions, 2006).
[29] "History of The Stock Market" (Be Businessed) <https://bebusinessed.com/history/history-of-the-stock-market> accessed on 25 October 2018.
[30] Reinhold C. Mueller, *The Venetian Money Market: Banks, Panics, and the Public Debt, 1200-1500* (Johns Hopkins University Press, 2019)
[31] *Ibid*
[32] Marianna Hunt, "How Belgium created and almost lost the world's first stock exchange" (28 June 2019) Brussels Times < https://www.brusselstimes.com/59675/how-belgium-created-and-almost-lost-the-worlds-first-stock-exchange> accessed 02 April 2024.
[33] Yusuf Perwej and Asif Perwej, "Prediction of the Bombay Stock Exchange (BSE) Market Returns Using Artificial Neural Network and Genetic Algorithm," *Journal of Intelligent Learning Systems and Applications*, vol. 4 (2012), pp.108-119.

By housing the traders, the Van der Bourse family revolutionised the stock market since for the first time, trading of debts and other securities took place under one roof. Traders exchanging debts and other securities no longer had to move over long distances seeking for other people interested in trading with them. This saved their time and the cost of doing business. Trading under one roof increased interaction amongst traders and the bond between traders increased the confidence and trust amongst themselves. This resulted in an increased confidence amongst traders not only in Van der Beurze's house but in the neighbouring cities. Other merchants from the neighbouring cities didn't want to lose an opportunity in venturing into the security markets. Perhaps, from the information they heard how trading in securities had flourished under Beurze's house. The stock trading generated huge interest from other merchants to the point of motivating them to join the pioneer traders in securities market at van der Beurze's house. The other neighbouring cities borrowed a leaf from Antwerp city. They also began trading in securities because it was a trade worth venturing. The idea quickly spread around Flanders and neighbouring counties and "Beurzen" soon opened in Ghent and Amsterdam. Trading securities under one roof spread from city to city till it reached to the capital city of Netherlands-Amsterdam, region to region till there came a time when trading in securities was prevalent throughout Europe.[34]

Therefore, it is conventionally accepted that in the whole world, it was in the city of Antwerp that the first capital market was formed. The capital market system then gained root and sprouted in the neighbouring cities and other countries. The stock market was a game changer as it encouraged trade under one roof and capital was readily availed through exchange of securities.

4.3 Evolution of Capital Market Regulation: From Absence to Establishment

In spite of the formation of the stock market, there was a noticeable absence of infrastructure, regulations and institutions as compared to the modern stock market. The organisational structure resembled the modern, the absence of the concept of the company impeded the growth the stock market. The practice of trading in shares of a company had not begun. The security market traders couldn't enjoy the advantages of trading in company shares such as limited liability.

4.3.1 Conceptualization of the Company

One of the most significant innovations in capital formulation is the conceptualization of the company. This innovation provides a platform for sourcing capital and employing experts who are not necessarily the owners. Moreover, it separates management from ownership and limits liability to the extent of one's share of ownership. The earliest companies were incorporated in England either through a royal charter or by a special Act of Parliament of the United Kingdom in the 17th century. Acquiring a royal charter or a special Act of Parliament was an expensive and tedious process as members of an association had to go through lengthy processes in order to be given the charter of incorporation. As a result, the formation of companies became a privilege of the ruling class. For many associations, seeking incorporation was an option way beyond their means. Therefore, royal charters and special Acts of Parliament could only be obtained by large associations with an enormous financial muscle. Unable to undergo the complex process of formal incorporation, most of the existing associations operated as if they were already incorporated, conducting transactions and engaging in business activities that were purposed for companies. Consequently, with few companies under charter, more partnerships came into existence to meet the huge commercial demand within the United Kingdom.[35]

As subscription to each company increased, the membership of each concern became very large thereby creating challenges in the management of its affairs. Consequently, it became evident that there was an urgent need to place the management of the company under a few trustees. As time went by, the concept of separating ownership and management of an entity was considered noble. As a result, various companies embraced the concept and introduced it into their companies. Thereby separating the shareholders and the management. The separation of the management from the ownership gave the management authority to steer the activities of the company without interference from the owners. This led to increased dividends as the companies were now led by managers with knowledge in finance.[36]

4.3.2 The East India Company

The feedback from European explorers regarding the Indian subcontinent created a wave of hysteria throughout Europe because India possessed numerous minerals and raw materials for industries. Therefore, most traders embarked on voyages to the Indian subcontinent. However, the journey to and from India was fraught with many obstacles and challenges such as bad weather, piracy among others. Most of the ships would lose

[34] B. Mark Smith, *A History of the Global Stock Market: From Ancient Rome to Silicon Valley* (The University of Chicago Press, 2004)
[35] M. Schmitthoff, "The Origin of the Joint-Stock Company", *University of Toronto Law Journal,* vol.3.1 (1939), pp.74-96.
[36] Segrestin Blanche, Andrew Johnston and Armand Hatchuel, "The separation of Directors and Managers: A Historical examination of the status of managers," *Journal of Management History,* vol.25.2 (2019), pp. 141-164.

their cargo at sea or would not return at all. As a result, ship owners embarked on a formula to mitigate risks by inviting investors to contribute funds to foot the cost of the voyage and in return, they would get dividends upon the safe return of the ship. However, this proved too risky because investors would lose all their investment in case the ship did not return. The ship owners came up with a concept of diversification in which an investor would invest in more than one ship so that if one didn't return safely then he wouldn't have lost all of his fortune. [37]

In 1600s, the British, French and Dutch gave charters to companies in the name East India. As a result, a unique corporation was formed in 1600 called "Governor and Company of Merchants of London trading with the East Indies" This was the famous English East India Company and it was the first company to use a limited liability formula.The above company would issue stocks and the investors would receive dividends on all the proceeds from all the ships of the company upon their return from India. This mitigated the liability of investors.[38] On the other hand, the Dutch East India Company (founded in 1602) was the first joint-stock company to get a fixed capital stock and as a result, continuous trade in company stock emerged on the Amsterdam Exchange. Soon thereafter, a lively trade in various derivatives, among which options and repos emerged on the Amsterdam market. Dutch traders also pioneered short selling - a practice which was banned by the Dutch authorities as early as 1610.[39]

4.3.3 The Bubbles Act

Unfortunately, there were no properly laid down laws regulating companies. The absence of a law regulating the conduct of companies became an avenue for fraudsters who posed as promoters calling for public subscription immediately after the formation of a company. The company would then disappear shortly after acquiring capital from the public through allotment of shares. In a stint of time the reputation of promoters was destroyed. The public lost confidence in them. Moreover, the separation of ownership from the management of the companies had made it easier for the members of the public to be duped since they weren't aware of the on goings in the companies. The promoters lured the members of the public to subscribe to such companies relying on the craze and rush that had ensued after the public learnt that the companies were huge profit making ventures. Especially with the fact in mind that such companies were made for the purpose of ship voyages to new 'worlds' recently discovered such as the Indian subcontinent. The public believed that there were vast natural resources in the Indian subcontinent and the subscription to such companies was the best way to get a share of the coveted wealth acquired from natural resources brought back to England through the ship voyages.[40]

With the absence of properly laid down laws to regulate company activities, the fraudulent promoters had a free hand to reign. They looted a huge chunk of money from the members of the public. The end result was a public outcry, enough was enough! As a result, the government came up with measures to curb such theft. The English Parliament empathised with the members of the public who had lost their investments to fraudulent promoters. In 1720 the Bubbles Act was enacted for the purpose of prohibiting the business of promoting companies.[41]

4.3.4 The Principle of Limited Liability

Perhaps the mood of the public was so incensed that Parliament didn't consider prohibiting only fraudulent promoters but the entire business of incorporating new companies. This was to the detriment of the growing trade and commerce which demanded for the formation of more companies to meet the needs of stakeholders. Furthermore, this prohibition lasted for over a century. It was not until 1825 that the Bubbles Act was repealed.[42]

With the prohibition of formation of new companies, more partnerships were formed some of which were large enough to the extent of having more partners than the membership of existing corporations. Consequently, the English government in 1844 required the registration and incorporation of large partnerships on a compulsory basis. Perhaps this was an awakening call to the British Parliament to rise to the occasion and attend to this challenge by enacting a statute that would facilitate a simplified incorporation of companies and repeal the Bubbles Act since it had negatively impacted trade and commerce in the United Kingdom. Due to the resultant stagnation in the capital market, other European countries had overtaken England as the pioneer in modern stock market, with this in mind, the English parliament rose to the occasion and enacted the Joint Stock

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[37] Kirti N. Chaudhuri, *The English East India Company: the Study of an Early Joint-Stock Company, 1600-1640* (Taylor & Francis, 1999).
[38] *Ibid*
[39] Lodewijk Petram, *The World's First Stock Exchange: How the Amsterdam Market for Dutch East India Company Shares became a Modern Securities Market, 1602-1700* (Doctoral thesis, Universiteit van Amsterdam, 2011).
[40] Patterson Margaret and David Reiffen, "The Effect of the Bubble Act on the Market for Joint Stock Shares," *The Journal of Economic History,* vol.50.1 (1990), pp.163-171.
[41] Royal Exchange and London Assurance Corporation Act, 1719 (commonly known as the Bubble Act) (6 Geo 1, c 18).
[42] Patterson, *note 40.*

Companies Act of 1844 which effectively repealed the Bubbles Act.[43] The Joint Stock Companies Act of 1844 was the premier law that regulated the incorporation of companies. It was seen as a positive measure towards promoting trade and commerce unlike the Bubbles Act.[44]

While progress had been made in registering them, these registered concerns were still known as partnerships and the principle of limited liability wasn't yet embraced. Therefore, despite the fact that the large partnerships had been incorporated the members of such concerns could not enjoy the advantages of incorporation because the principle of unlimited liability was still in practice, therefore even after incorporation, the private property of members of such concerns was attached or repossessed in order to recover debts or losses owed by such concerns. To foster one of the key principles characterising the company, the principle of limited liability was granted and put into practice in 1855 through the Limited liability Act.[45] Ultimately, the various statutes relating to companies were consolidated into the Joint Stock companies Act, 1856.[46]

4.4 The Rise of Modern Stock Exchanges

Having noted that for a long time, the Bubbles Act prohibited the business of incorporation part of which is the issuance of shares and other securities in the primary capital market thereby limiting commerce and trade transactions within the United Kingdom. In spite of all these, the London Stock Exchange came into existence in 1801. The ban on issuance of shares didn't do the London stock exchange any good as it stagnated the earlier progress in England's capital market. Had the ban been inexistent or had it been lifted early enough, the London stock exchange could have lived to its full potential. In true sense the ban restrained the London stock exchange from becoming a global financial power. With the London stock exchange shackled by the Bubbles Act other stock exchanges were formed and eventually took lead in the establishment of a thriving stock exchange.[47]

At the forefront was the New York Stock Exchange (NYSE) which was formed in 1817. Its creation was a watershed moment in history. This is mainly because the New York stock exchange began trading since its very first day of inception. Contrary to claims that the New York stock exchange was the first modern stock exchange, founded in 1790, the Philadelphia stock exchange was the premier stock exchange in the United States of America. Due to its strategic location at the centre of commerce and trade in the United States in New York, the New York stock exchange grew by bounds. The absence of competition within the United States of America gave NYSE a freehand in stock market trade. Soon, NYSE entrenched its place as the best and most powerful stock exchange in the United States of America this further propagated its status internationally. With the London stock exchange shackled, NYSE cemented its place globally as the biggest stock exchange in the world. [48] The London stock exchange remained a power to reckon in Europe. Regrettably, despite the fact that it was the pioneer stock exchange, it was quickly overtaken in the global sphere due to its limitations and inabilities to fully transact due to restrictions imposed by the Bubbles Act.[49]

4.5 Stock Market's Influence on the Economy

In the 21st century, no country can claim to be a major global economic giant without an efficient, modern and swift stock market. In the modern age, the stock exchange of a country is intricately tied to its economy that a slump or a crush of the stock market sends shockwaves across the economy. Generally speaking, the stock market reacts to the prevailing economic conditions of an economy.[50]Therefore, countries endeavour to formulate regulations while keeping a constant keen eye on their stock markets to ensure they are sound and stable because a tiny fluctuation of their indices could lead to unforeseen financial consequences. The governments of the day take precautions especially when formulating policies, they review the effect of such policies on the stock market and are generally reluctant to enact those that will disrupt the trends in the markets. Such governments are keen to ensure that their stock markets aren't volatile but stable. This is because stable stock markets attract investors not only locally but also internationally. The tendency of a stock market to attract investors to invest their savings is known as investor confidence.[51]

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[43]Todd Geoffrey, "Some Aspects of Joint Stock Companies, 1844-1900," *The Economic History Review,* vol.4.1 (1932), pp. 46-71.

[44] Joint Stock Companies Act 1844 (7 & 8 Vict. c. 110).

[45] Limited Liability Act 1855 (18 & 19 Vict. c. 133).

[46]Joint Stock Companies Act 1856 (19 & 20 Vict. c. 47).

[47] Ranald Michie, *The London Stock Exchange: A History* (Oxford: Oxford University Press, 2001).

[48]Library of Congress, "Wall Street and the Stock Exchanges: Historical Resources, "obtained from < https://guides.loc.gov/wall-street-history/exchanges> accessed on 02 April 2024.

[49] Ranald, *note 47.*

[50] Achin Goel, "Relationship between Stock Market and Economy," *Economic Times* (10 January 2023).

[51] Bekaert Geert and Campbell R. Harvey, "Capital Markets: An Engine for Economic Growth." *The Brown Journal of World Affairs* 5.1 (1998): 33-53.

4.6 Most Devastating Stock Market Crashes Globally

Stock markets are often fragile and are vulnerable to various factors such as political instability, fiscal policy changes among others. A stock market crash is when a stock index drops severely in a day or two of trading. The public plays a huge role in the stock market crash for instance as it happened in the 1700s where there was a rush of members of the public to subscribe into companies conducting voyages to the Indian subcontinent. They did so with a high hope to get huge dividends when the ships return from their voyage. This led to a bubble. Market crushes are spiked by speculative tendencies in part by traders. In the modern world when shares and other securities are traded at a high and unsustainable price, this is considered to be bubble. And in most of the time a high rise in price of shares of a certain commodity to unsustainable rate is followed by a fall; a tumble. Therefore, a bubble is likely to be followed by tumble. [52]

"An economic bubble, also known as a market bubble or price bubble, occurs when securities are traded at prices considerably higher than their intrinsic value, followed by a 'burst' or 'crash', when prices tumble. The term is commonly used when talking about the property market (housing bubble)". It is a common trend that stock market crashes are preceded by speculative tendencies of investors stretched beyond the actual value of a stock.[53]

Perhaps Black Thursday was the most devastating stock market crash in the world that rattled investors and shook them to the core. It was on a terrible Thursday in 1929 when the stock market crashed followed by Black Monday and Black Tuesday. It was in this crash that the index of the New York stock exchange (the Dow Jones) industrial average lost 50% of its value.[54]The stock market crash on Black Thursday, Black Monday and Black Tuesday had far reaching consequences. Most of the global economy was sent into a deep plunge. The ensuing depression wiped out billions of dollars.

The following are stock market crashes that occurred thereafter;

a. Stock market crash of 1973-74
b. Black Monday of 1987
c. Dot com bubble of 2000
d. Stock market crash of 2008

However, none of the above stock market crashes can be compared to the 1929 stock market crash. They are simply a storm in the cup compared to the Black Thursday crash. The 1987 stock market crash was the first one in the era of electronic era and to the dismay of many financial analysts, no one foresaw the tumble. It caught everyone by surprise. It commenced in Hong Kong wherein the market tumbled by 45.5% between October 19 and October 31. As the month of October neared its end, stock markets of global economic powers were hit by the shock waves of the tumble of the Hong Kong Stock market. Just as Hong Kong stock market, the global economic powers' stock markets crashed by double digits. The collapse saw the United States of America and Canadian stock markets tumble by approximately 23%. The Australian stock market was hit hardest by the shock waves of the crash; it fell by approximately 42%.[55]

V. Conclusion

This paper has traced the evolution of the capital market from its rudimentary form to various innovations along the way including housing market traders in one house that later became the stock market. It has also discussed the financial instruments used by early traders and the regions that pioneered stock market trading.

A significant portion of this paper has been dedicated to discuss the earlier efforts to regulate the capital market and how the statutory requirement for the incorporation of large partnerships and associations into companies streamlined the capital market. Further, modern capital market regulators can draw lessons on how red tape and stringent requirements imped the incorporation of more companies thereby limiting entrepreneurship. Moreover, it has been demonstrated that market regulatory institutions need to consider the implications of corrective efforts before implementing them for instance; a blanket prohibition of incorporation companies with the objective of preventing fraudulent promoters from duping the public eventually stifled the growth of the English capital market thereby stagnating the London Stock Exchange as one of the leading global secondary capital markets. Therefore capital market regulation should strike a balance between promotion of flow of capital in order to keep the market thriving and protection of investors and the public at large.

Shedding light on the significance of the capital market in economic growth, this researcher underlines that the modern stock market is intertwined with the national economy and is considered the barometer or a

[52] G. Yu, *Empirical Essays on Stock Market Bubbles*, (Doctoral dissertation, Newcastle University, 2020).
[53] *Ibid*
[54] Harold Bierman Jr., *The Causes of the 1929 Stock Market Crash: A Speculative Orgy or a New Era?* (Bloomsbury Publishing USA, 1998).
[55] Katsunari Yamaguchi, "The History and Economics of Stock Market Crashes" in Laurence B. Siegel (ed.), *Insights into the Global Financial Crisis* (CFA Institute Research Foundation, 2009) 132.

measure of the condition of the economy. Therefore, more efforts should be made to ensure efficient regulation of the stock market since it promotes the confidence of investors to avail more capital for utilisation by enterprises leading to economic growth.

Finally, with the integration of trade and commerce among nation states throughout the globe, stock markets have become the symbol of global trade. While nation-states remained largely unaffected by the economic failures in other nation- states centuries ago, in recent times as demonstrated by stock market crashes, it has become apparent that economic failures in one nation-state can send shock waves to other regions. Therefore, it is critical for capital market regulators in various jurisdictions to work in tandem to maintain a global outlook while keeping a watchful eye on market players to ward off unethical activities such as insider trading and excessive speculative tendencies brought by greed which could bring the global economy to its knees. Above all, it should be emphasised that capital market regulators should endeavour to maintain the tricky balance between protecting investors, providing a thriving environment that not only encourages more investment but also facilitates seamless trading among market players.