

# Rejuvenating the Indian Capital Market

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## Abstract

In 2025, foreign portfolio investors withdrew nearly USD 17 billion from Indian equities, and the country also faced high U.S. tariffs on its exports. Despite these setbacks, Indian retail investors became key buyers through systematic investment plans (SIPs) and direct stock purchases, helping to cushion the impact of FPI outflows. Monthly SIP contributions reached record highs, showing growing trust in equity mutual funds for long-term financial growth. In response, SEBI, the securities market regulator, introduced reforms to attract foreign investors and revitalize the capital market. To find effective strategies for this effort and boost capital formation, the researcher consulted both experts and traders. Their feedback suggests that SEBI should launch new products such as sectoral, thematic, volatility-based, and ESG-linked derivatives, and also revive less-used asset classes like currency and interest rate derivatives. Building a strong securities lending and borrowing (SLB) system is also recommended. SEBI should reduce the number of contract expiries and increase lot sizes to make futures and options (F&O) trading more expensive for individuals. This is important because short-term derivatives, unlike long-term ones, do little to support capital formation and can increase market volatility. Finally, allowing netting across different stocks would let investors, especially foreign ones, offset buy and sell trades and lower the capital needed for trading.

**Keywords:** cushion; rejuvenate; robust; sectoral; stakeholder; tariff; thematic

## 1. Theoretical background of the topic

An examination of India's capital markets indicates a pressing need to strengthen the cash equities segment, especially as ultra-short-term derivatives trading has become increasingly dominant. This disparity between cash and derivatives markets poses significant challenges for the overall market health. According to studies connected to SEBI and various media sources, retail investors' net losses from derivatives expanded notably in FY2024–25, amounting to INR 1.06 trillion—a 41% increase over the previous year. India's derivatives market is globally exceptional in scale, outstripping the cash equity market by a factor of ten. In fact, the total size of derivatives activity is now more than 300 times that of the cash market, a divergence from international norms. Although the rise in retail investors and demat accounts appears positive on the surface, the heightened retail involvement in index options is a cause for concern. Regulators face the difficult task of balancing market stability with the need to foster innovation and responsible risk-taking. Expanding and deepening the capital markets is essential to correcting these imbalances.

## 2. Statement of the problem

An examination of India's capital markets indicates a pressing need to strengthen the cash equities segment, especially as ultra-short-term derivatives trading has become increasingly dominant. This disparity

between cash and derivatives markets poses significant challenges for the overall market health. According to studies connected to SEBI and various media sources, retail investors' net losses from derivatives expanded notably in FY2024–25, amounting to INR 1.06 trillion—a 41% increase over the previous year. India's derivatives market is globally exceptional in scale, outstripping the cash equity market by a factor of ten. In fact, the total size of derivatives activity is now more than 300 times that of the cash market, a divergence from international norms. Although the rise in retail investors and demat accounts appears positive on the surface, the heightened retail involvement in index options is a cause for concern. Regulators face the difficult task of balancing market stability with the need to foster innovation and responsible risk-taking. Expanding and deepening the capital markets is essential to correcting these imbalances.

### 3. Review of literature

**In the following paragraphs, some of the studies on the research topic are reviewed:**

1. SEBI is concerned with the growing dominance of ultra-short-term derivatives trading (Business Standard, 2025). It fears that the development could affect the health of the country's capital markets. It is considering extending the tenure and maturity of the derivative products, as a result. Very short-term derivatives continue to dominate equity derivative volumes -- in particular, the expiry-day index options. SEBI's Whole-Time Member Ananth Narayan views the imbalance as unhealthy. According to him, the trend has the potential to snowball into adverse consequences.
2. Quoting SEBI, Reuters states that India must look for more ways to further deepen its cash equities markets (Reuters, 2025). Parallely, it should take steps to further raise the quality of its derivatives market by extending the tenure and maturity of the products and solutions on offer. The surge in derivatives trading, which has also been driven by retail investors, definitely disproportionately, has prompted SEBI to limit the number of contract expiries and increase lot sizes to render such trades more expensive.
3. India's derivatives market has been among the most active in the world (Risk Awareness, 2025). Record retail participation, a raft of regulatory interventions, high-profile market-manipulation probes, and a growing interest-rate-derivatives ecosystem have characterised the market over the past two years. The developments led the exchanges, clearinghouses, and regulators to review market design, risk controls, and participant access. A more sophisticated and a more tightly governed market has emerged as a result, says the researcher.
4. Ravi asserts that India's derivatives market remains one of the remarkable success stories of financial modernization (Ravi, 2025). What began in 2000 with index futures has evolved into the world's largest derivatives marketplace -- deep, liquid, and integral to the financial system. But the next leap forward should be determined by vision and better market design. It should widen product spectrum and participant base. The resultant ecosystem should be able to serve not just traders but also institutions, corporates and even farmers who need efficient risk-transfer mechanisms, adds the researcher for good measure. Interestingly, he states that by any sensible measure, the size of India's index options market is in line with global norms. It is certainly not out of proportion with the size of the economy or market structure.
5. Sheth reminds that India's derivatives market dwarfs its cash equity market by as much as 10 times, in terms of size (Sheth, 2025). The market stands out for its elevated levels of retail participation, in particular, in index options. The researcher is quick to point out that liquidity disparity enabled a so-

phisticated trading firm to influence the underlying index with small trades in cash equity. In the process, the trading firm registered massive gains in the more active derivatives market. The researcher recalls that during the year, SEBI released a raft of new regulations in quick succession. Admittedly, some may swear by a more gradual approach, with more time between the release of new rules. But, given the pace at which India's markets are growing, justifies such a proactive approach, adds the researcher. He believes that SEBI has by and large struck the right balance in pursuing its mandate

6. Upadhyay and Dugal state that SEBI plans more reforms to woo foreign investors. Speeding up registration, reducing the cost of trading in the cash equities market, and easing short-selling figure in the list of reforms (Upadhyay & Dugal, 2025). In a year when foreign investors have pulled out nearly USD 17 billion from Indian equities and the economy is facing pressure from high tariffs imposed by the U.S on India's exports, the reforms have not come a day too soon, add the researchers.

#### 4. Research gap

The learned researchers have by and large focused on the impact of ultra-short-term derivatives on the health of the country's capital markets. Some researchers have suggested, at a relatively macro level, how the products can be redesigned along investment parameters, risk parameters, etc, so that the retail investor community is adequately protected and capital formation is triggered. The latter is more important in the backdrop of foreign portfolio investors pulling out of the capital markets for one reason or the others lately. Fortunately, the growing retail investor community has been steadily stepping into the breach by investing copiously through mutual funds, in particular. Welcome though it is, one should remember that it is a temporary or a stop-gap relief measure and one never knows when it will sputter. In the circumstances, a superior and fool-proof way of ensuring capital formation should be thought of -- like widening the capital markets and deepening the capital markets. One wishes that the learned researchers had thrown more light on this aspect too. It is this gap the present study seeks to plug.

#### 5. Scope of the present study

This research is limited to two groups of participants: 100 capital market experts and 60 capital market traders, all of whom are based in Bengaluru (Urban) and Bengaluru (Rural) districts.

#### 6. The study's goals

The study's goals are to:

1. Find out what the respondents think about the state of the capital market.
2. Determine the actions required to revitalize the capital market

#### 7. A hypothesis to be investigated.

The following hypothesis is intended to be tested by the study:

"The revitalization of the capital market and the strength of the securities lending and borrowing (SLB) ecosystem are independent."

#### 8. Design of research

The research methodology is provided in the paragraphs that follow.

##### 1.8.1 Research techniques

The "fact-finding" survey method was employed in this descriptive study.

**1.8.2 Data sources**

Both primary and secondary sources have provided the data needed for the study. Thirty traders and fifty capital market professionals provided primary data.

Secondary data has been gathered from the websites of the RBI, the government of India (GoI), and the financial press in both digital and paper copy.

**1.8.3 Plan for sampling**

Fifty capital market professionals were chosen by the researcher. For this goal, he employed the purposive or judgment sampling methodology under the non-probability method.

Traders: Using the purposive or judgment selection methodology under the non-probability method, the researcher chose thirty traders for the study.

**1.8.4 Data collection instruments**

The researcher administered interview schedules to the respondents and interacted with them for collection of primary data.

**1.8.5 Plan for data processing and analysis**

The researcher processed the data using both mechanical and manual techniques. For data analysis, reporting, and deployment, he employed the Microsoft Excel spreadsheet program. He employed a 4-point Likert scale to elicit the respondents' answers to the questions posed in the Interview Schedule in order to gather primary data. To make sure that the respondents were required to voice their opinions, the researcher employed a 4-point Likert scale.

**1.8.6 Study limitations**

Through ongoing, topic-focused conversations with the respondents, the researcher also deduced primary data. The researchers' opinions may have been impacted to some extent by subjectivity. Nonetheless, the researcher is certain that any subjectivity is too minor to have an impact on the calibre of the study's conclusions.

**9. Analysis of primary data gathered from fifty respondents who are experts.**

The major data gathered from the 100 expert responses is examined in the paragraphs that follow.

**1.9.1 Respondents' opinions on the state of the stock market today**

Different stakeholder segments may have different opinions about the capital market's current state. Therefore, the researcher asked the former experts if they agreed with the viewpoints listed in the table below. Four levels—Strongly Agree, Agree, Disagree, and Strongly Disagree—are used to indicate whether or not respondents agree with the viewpoints. The corresponding values for these variates are 1, 2, 3, and 4.

**Table-1 Perspective of the respondents on the current status of the capital market**

Sl No	Perspective	Strongly agree (1)	Agree (2)	Disagree (3)	Strongly disagree (4)	Total (5)
a)	Ultra-short-term derivatives dominate the market	70	24	4	2	100
b)	Expiry-day index option turnover often exceeds the cash market by a whopping margin	62	28	6	4	100

c)	Domestic institutions face regulations that limit their ability to hedge, innovate, and manage risk effectively.	56	26	10	8	100
d)	Excessive regulation raises compliance costs, curb innovation and constrain institutions' ability to use a range of tools to manage their risk effectively.	58	18	18	6	100
e)	Excessive regulation spawns turf battles, delays introduction of new instruments and fragments the market along geographies or sectors	54	14	22	10	100
f)	The market ecosystem must mature to serve institutions, corporates and farmers who miss efficient risk-transfer mechanisms	58	24	14	4	100
g)	Regulators should remain focused on striking the right balance between ensuring market stability and promoting innovation and prudent risk-taking	62	26	6	6	100
<b>Total</b>		<b>420</b>	<b>160</b>	<b>80</b>	<b>40</b>	<b>700</b>

Ultra-short-term derivatives dominate the market, according to 94 respondents. The remaining six respondents beg to differ. Expiry-day index option turnover often exceeds the cash market by a whopping margin, according to 90 respondents. The remaining ten beg to differ. Domestic institutions face regulations that limit their ability to hedge, innovate, and manage risk effectively, according to 82 respondents. The remaining eighteen would beg to differ. Excessive regulation raises compliance costs, curb innovation and constrain institutions' ability to use a range of tools to manage their risk effectively, according to 76 respondents. The remaining 24 would beg to differ. Excessive regulation spawns turf battles, delays the introduction of new instruments and fragments the market along geographies or sectors, according to 68 respondents. The remaining 32 would beg to differ. The market ecosystem must mature to serve institutions, corporates and farmers who miss efficient risk-transfer mechanisms, according to 82 respondents. The remaining eighteen would beg to differ. Regulators should remain focused on striking the right balance between ensuring market stability and promoting innovation and prudent risk-taking, according to 88 respondents. The remaining twelve would beg to differ.

### 1.9.2 Measures needed to rejuvenate the capital market

Having apprised himself of the perspectives of the respondents on the current status of the capital market, the researcher sought to ascertain from the respondents the measures needed to rejuvenate the capital market. Their replies to the query are tabulated below. The replies are expressed at four levels, namely,

Strongly Agree, Agree, Disagree and Strongly Disagree. These variates are assigned the values 1, 2, 3 and 4, respectively.

**Table-2 Measures needed to rejuvenate the capital market**

Sl No	Measures	Strongly agree (1)	Agree (2)	Disagree (3)	Strongly disagree (4)	Total (5)
a)	Extend the tenure and maturity of ultra-short-term derivatives	56	26	14	4	<b>100</b>
b)	Deepen the cash market segment to wean away retail investors from derivatives	42	50	4	4	<b>100</b>
c)	Prescribe a cooling period for retail investors in the F&O equity market	38	40	14	8	<b>100</b>
d)	Mandate professional training in the F&O equity market for retail investors.	44	38	12	6	<b>100</b>
e)	Deepen the cash market by expanding single stock derivatives;	34	52	10	4	<b>100</b>
f)	Create a robust securities lending and borrowing (SLB) ecosystem	38	48	8	6	<b>100</b>
g)	Revive the currency derivatives market with unified regulatory support	28	44	18	10	<b>100</b>
h)	Ensure parity by allowing co-location facility in commodity markets	36	58	4	2	<b>100</b>
i)	Introduce fixed income index derivatives by revamping the retail F&O access.	32	60	4	4	<b>100</b>
	<b>Total</b>	<b>348</b>	<b>416</b>	<b>88</b>	<b>48</b>	<b>900</b>

Extend the tenure and maturity of ultra-short-term derivatives, suggest 82 respondents. The remaining eighteen respondents would beg to differ. Deepen the cash market segment to wean away retail investors from derivatives, suggest 92 respondents. The remaining eight respondents would beg to differ. Prescribe a cooling period for retail investors in the F&O equity market suggest 78 respondents. The remaining 22 respondents would beg to differ. Mandate professional training in the F&O equity market for retail investors. Suggest 82 respondents. The remaining eighteen respondents would beg to differ. Deepen the cash market by expanding single stock derivatives, suggest 86 respondents. The remaining 14 respondents would beg to differ. Create a robust securities lending and borrowing (SLB) ecosystem, suggest 86 respondents. The remaining 14 respondents would beg to differ. Revive the currency derivatives market with unified regulatory support, suggest 72 respondents. The remaining 28 respondents would beg to differ. Ensure parity by allowing a co-location facility in commodity markets, suggest 94 respondents. The

remaining six respondents would beg to differ. Introduce fixed income index derivatives by revamping the retail F&O access., suggest 92 respondents. The remaining eight respondents would beg to differ.

**1.10 Examination of basic data gathered from thirty merchants**

The major data gathered from the 60 trader respondents is examined in the paragraphs that follow.

1.10.1 Respondents' opinions on the state of the stock market today  
 Different stakeholder segments may have different opinions about the capital market's current state. Therefore, the researcher asked the former experts if they agreed with the viewpoints listed in the table below. Four levels—Strongly Agree, Agree, Disagree, and Strongly Disagree—are used to indicate whether or not respondents agree with the viewpoints. The corresponding values for these variates are 1, 2, 3, and 4.

**Table-3 Perspective of the respondents on the current status of the capital market**

Sl No	Perspective	Strongly agree (1)	Agree (2)	Disagree (3)	Strongly disagree (4)	Total (5)
a)	Ultra-short-term derivatives dominate the market	20	34	4	2	60
b)	Expiry-day index option turnover often exceeds the cash market by a whopping margin	22	34	2	2	60
c)	Domestic institutions face regulations that limit their ability to hedge, innovate, and manage risk effectively.	18	28	4	10	60
d)	Excessive regulation raises compliance costs, curb innovation and constrain institutions' ability to use a range of tools to manage their risk effectively.	16	26	12	6	60
e)	Excessive regulation spawns turf battles, delays introduction of new instruments and fragments the market along geographies or sectors	24	30	4	2	60
f)	The market ecosystem must mature to serve institutions, corporates and farmers who miss efficient risk-transfer mechanisms	14	24	12	10	60
g)	Regulators should remain focused on striking the right balance between ensuring market stability and promoting innovation and prudent risk-taking	20	36	2	2	60
	<b>Total</b>	<b>134</b>	<b>212</b>	<b>40</b>	<b>34</b>	<b>420</b>

Ultra-short-term derivatives dominate the market, according to 54 respondents. The remaining six respondents beg to differ. Expiry-day index option turnover often exceeds the cash market by a whopping margin, according to 56 respondents. The remaining four beg to differ. Domestic institutions face regulations that limit their ability to hedge, innovate, and manage risk effectively, according to 46 respondents. The remaining 14 would beg to differ. Excessive regulation raises compliance costs, curb innovation and constrain institutions' ability to use a range of tools to manage their risk effectively, according to 42 respondents. The remaining 18 would beg to differ. Excessive regulation spawns turf battles, delays introduction of new instruments and fragments the market along geographies or sectors, according to 54 respondents. There remaining six would beg to differ. The market ecosystem must mature to serve institutions, corporates and farmers who miss efficient risk-transfer mechanisms, according to 38 respondents. The remaining 22 would beg to differ. Regulators should remain focused on striking the right balance between ensuring market stability and promoting innovation and prudent risk-taking ,, according to 56 respondents. The remaining four would beg to differ.

**1.10.2 Measures needed to rejuvenate the capital market**

After learning about the respondents' opinions on the state of the capital market, the researcher tried to find out from them what steps were required to revitalize the market. Below is a tabulation of their responses to the question. Strongly Agree, Agree, Disagree, and Strongly Disagree are the four levels at which the responses are expressed. The corresponding values for these variates are 1, 2, 3, and 4.

**Table-4 Measures needed to rejuvenate the capital market**

Sl No	Measures	Strongly agree (1)	Agree (2)	Disagree (3)	Strongly disagree (4)	Total (5)
a)	Extend the tenure and maturity of ultra-short-term derivatives	22	30	4	4	<b>60</b>
b)	Deepen the cash market segment to wean away retail investors from derivatives	20	26	4	10	<b>60</b>
c)	Prescribe a cooling period for retail investors in the F&O equity market	18	38	2	2	<b>60</b>
d)	Mandate professional training in the F&O equity market for retail investors.	24	30	4	2	<b>60</b>
e)	Deepen the cash market by expanding single stock derivatives;	30	26	2	2	<b>60</b>
f)	Create a robust securities lending and borrowing (SLB) ecosystem	28	20	6	6	<b>60</b>
g)	Revive the currency derivatives market with unified regulatory support	34	22	2	2	<b>60</b>

h)	Ensure parity by allowing co-location facility in commodity markets	24	32	2	2	60
i)	Introduce fixed income index derivatives by revamping the retail F&O access.	13	15	1	1	30
<b>Total</b>		<b>226</b>	<b>254</b>	<b>28</b>	<b>32</b>	<b>540</b>

Extend the tenure and maturity of ultra-short-term derivatives, suggest 52 respondents. The remaining eight respondents would beg to differ. Deepen the cash market segment to wean away retail investors from derivatives, suggest 46 respondents. The remaining 14 respondents would beg to differ. Prescribe a cooling period for retail investors in the F&O equity market suggest 56 respondents. The remaining four respondents would beg to differ. Mandate professional training in the F&O equity market for retail investors. suggest 54 respondents. The remaining six respondents would beg to differ. Deepen the cash market by expanding single stock derivatives, suggest 56 respondents. The remaining four respondents would beg to differ. Create a robust securities lending and borrowing (SLB) ecosystem, suggest 48 respondents. The remaining 12 respondents would beg to differ. Revive the currency derivatives market with unified regulatory support, suggest 56 respondents. The remaining four respondents would beg to differ. Ensure parity by allowing co-location facility in commodity markets, suggest 56 respondents. The remaining four respondents would beg to differ. Introduce fixed income index derivatives by revamping the retail F&O access., suggest 56 respondents. The remaining four respondents would beg to differ.

### 1.11 Conclusions

Conclusions pertain to hypotheses and are inferences or generalizations derived from the data. They are responses to the study questions or declarations of hypothesis acceptance or rejection. This study aims to evaluate the following hypothesis, as previously explained.

#### 1.11.1 Hypothesis testing

"The revitalization of the capital market and the strength of the securities lending and borrowing (SLB) ecosystem are independent."

Ho and Ha are therefore as follows:

Ho: The revitalization of the capital market and the strength of the securities lending and borrowing (SLB) ecosystem are unrelated.

Ha: The revitalization of the capital market depends on the strength of the securities lending and borrowing (SLB) ecosystem.

The researcher used a chi-square test to determine whether there was any correlation between the variables based on the primary data gathered from the respondents, as shown in Tables 2 and 4. The computation done with Microsoft Excel is shown in the following table.

	Category	Observed Values		
		Agree	Disagree	Total
	Experts	86	14	100
	Traders	48	12	60
	Total	134	26	160
		Expected Values		

	Category	Agree	Disagree	Total
	Experts	83.75875	16.25	100
	Traders	50.25	9.75	60
	Total	134	26	160
		Agree	Disagree	
	o-e	2.2500	-2.2500	
2		-2.2500	2.2500	
	(o-e) <sup>2</sup>	5.0625	5.0625	
		5.0625	5.0625	
	((o-e) <sup>2</sup> )/e	0.0604	0.3115	
		0.1007	0.5192	
	CV	0.1612	0.8308	0.9920
	TV			3.8415
	p			0.3193

The calculated value of  $\chi^2$  is 0.3193, lower than the table value of 3.8415 for an alpha of 0.05 at one degree of freedom.  $p=0.3193>0.05$ , the alpha level. Hence  $H_0$  is not rejected.

### 1.12 Suggestions

In light of the conclusions reached, the researcher recommends expanding and deepening the capital market as follows:

1. To increase the cost of individual futures and options (F&O) trades, SEBI should restrict the quantity of contract expiries and increase lot sizes. This is crucial because short-term derivatives, in contrast to longer-term derivatives, may increase market volatility and contribute little to capital formation, among other things.
2. SEBI should introduce next generation products that embrace, inter alia, sectoral, thematic, volatility, and ESG-linked derivatives. Parallely, it should revive dormant asset classes like currency and interest rate derivatives.
3. Isolating the equity markets from the commodity markets makes little sense, given that modern finance has been witnessing increasing integration these days, leading to significant benefits in terms of capital efficiency, risk management, and overall market resilience. Such integration is a positive sum game.
4. AI-enabled surveillance, real-time risk analytics and responsive margin and expiry frameworks can render markets safer and more attuned to investor needs.
5. Since it enables investors to net off buy and sell trades, netting across different scrips ought to be allowed. It will reduce the amount of money that investors, especially foreign investors, need to finance their trading activities..

Sebi should mandate retail investors to undergo professional training in derivatives trading; alternatively, it should prescribe a diploma course in derivatives trading for retail investors.

Globally, markets allow at least 70 percent of traded stocks to be part of the derivatives segment. Studies across the globe reveal that introduction of single stock options leads to an 80–120 percent raise in cash market volumes. In India too, expanding the derivatives basket will raise retail and institutional participation, culminating in an improvement in overall market depth and resilience. Expansion of single stock derivatives is overdue.

Sebi should ensure a robust securities lending and borrowing (SLB) ecosystem. Presently, the SLB market remains underdeveloped owing to high margin costs (100 percent) and low retail awareness. If Sebi rationalises margin requirements, retail access to SLB platform will improve. A well-functioning SLB ecosystem will help investors hedge or take positions without relying on derivatives all the time. It will help curb excessive speculative activity and promote the health of the market.

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