

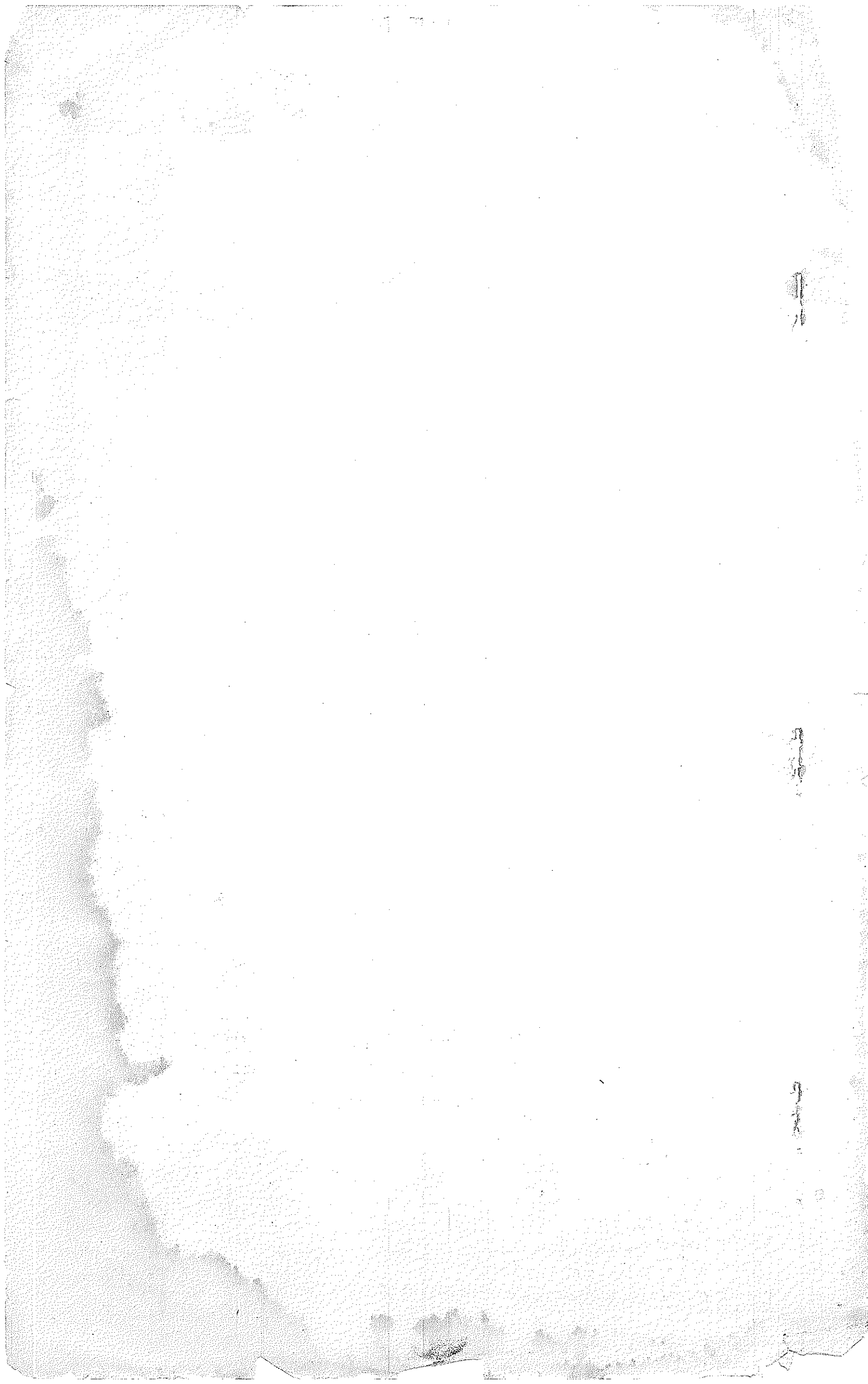
STOCK EXCHANGES IN INDIA  
EMERGING SCENARIO AND CHALLENGES

BY

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Facts do not cease to exist because they are ignored.

- Aldous Huxley

## STOCK EXCHANGES IN INDIA

### Emerging Scenario and Challenges

I am thankful to the Chairman and the Board of Trustees of the A.D. Shroff Memorial Trust for doing me the honour to deliver this Shroff Memorial Lecture, this year.

I had numerous occasions to come into close contacts with late Shri Shroff, during my earlier career with the New India Assurance Co. Ltd., of which he was, the then Chairman. I am personally indebted to him and to Mr. B.K. Shah, who was then M.D. of the said Company, for guiding and encouraging me to put in my best in any assignments they gave me, particularly in the field of investments and credit insurance. Mr. Shroff had, in fact, enabled me to have some training, in the art and techniques of investments, with a number of institutions in the U. K. and the U.S.A. I still cherish his memory and respect and admire him not only for his deep knowledge and understanding of the intricacies of industry, finance and trade but also because he had intellectual honesty, courage of his convictions and had stood for certain values in life. He was, moreover, forthright in the expression of his views. More than that, he was man of vision. Apart from being one of the authors of the Bombay Plan in 1944 and the Chairman of the Committee on Industrial Finance set up by the R.B.I. in 1954, he was instrumental in the formation and successful functioning of a number of industrial enterprises, including the I.C.I.C.I., and was on some of their Boards of Directors. As early as 1954, he had advocated the establishment of mutual trusts and unit trusts to mobilise the savings of the community and to encourage capital formation in the country. He was also in favour of forming a consortium of financial institutions to underwrite new issues of capital and even to encourage venture capital. It was, at his instance, that the 'New India' had taken the lead in underwriting new issues in those days and had even submitted to the Government a proposal for the 'New India' to start a Unit Trust.

Today, I have deliberately selected a subject which was dear to Mr. Shroff, to pay my humble homage to his revered memory.

I intend to divide the subject under five major heads (A) Introduction, (B) Stock Exchanges in India - brief macro-level view (C) Emerging Scenario, (D) Review of Recent trends in the Stock Exchanges abroad and (E) Challenges ahead.

(A) Introduction:

We have accepted mixed economy as the sheet-anchor of our planned national endeavour with a view to achieving a major breakthrough in the barriers of poverty and ensuring richer and fuller lives to our people, through higher standards of living. In such a scheme of things, while the Public Sector occupies the commanding heights and even some of the strategic foothills of the economy, the Private Sector is assigned the rest of the terrain. Specific physical targets are set and estimates of required quantum of resources are worked out to achieve definite goals outlined in the Five Year Plans framed from time to time.

It is now, ungrudgingly, realised that the mainsprings of human action and excellence - individual initiative, enterprise, drive and a sense of dedication and purpose, and not finance alone, are vital to generate necessary impulses of growth and to evoke maximum contribution, from both the Public and Private Sectors, to promote growth and bring about socio-economic transformation of the country. It is equally realised that any shortcomings or failings of either can be equally disastrous to our national interests.

Unfortunately, mobilisation of more and more financial resources, year after year, are now required to produce the same given volume of output and to maintain existing standards of living in the face of explosive growth of population. At the same time the economy is experiencing scarcity of resources. I need not go into the reasons, thereof, as they are well known. Such a situation is causing grave national concern.

Realising the gravity of the resource crunch in the economy and the need to devote more resources to national priorities, the public sector enterprises are directed to take urgent steps to improve the efficiency of their operations and generate surpluses

to reduce their dependence on budgetary support and to ease thereby the burden on the national Exchequer. Lately, they are asked to subject themselves to the discipline of the markets and raise resources directly from the public. Similarly, the private sector is asked to tone up its efficiency and also to raise the required resources from the capital market without undue reliance on the resources of the public sector financial institutions.

Simultaneously, the Government is pursuing market-oriented policies in respect of both the Sectors to step up their competitive efficiency, stimulate their diversified growth and to improve their financial performance.

It is against such a background that the role of the Stock Exchanges assumes an added importance in enabling both the Public and the Private Sectors to raise maximum resources from community.

(B) STOCK EXCHANGES IN INDIA -  
A BRIEF MACRO - LEVEL VIEW.

I propose to deal briefly, with a few aspects of the character and functioning of the Stock Exchanges in the country.

The Stock Exchanges in the country witnessed, since November 1984, an upsurge of unprecedented buoyancy and virtually 'lit up the heavens', mainly after the advent of the new government headed by the present Prime Minister and its pursuit of refreshingly pragmatic and market-oriented policies, aimed at giving a new thrust and direction to the national economy. Even though the Stock Exchanges tended to sober down and adjust themselves to more realistic levels, after February 1986, the continuous plummeting of prices on account of one reason or the other till the first week of December 1986, compelled the Stock Exchange authorities to employ practically all the conceivable regulatory weapons in their armoury, including the fixing of floor prices of shares and even the closure of the markets, in an effort to avert their complete collapse. It was, ultimately, the intervention of the institutions at the reported instance

of the Prime Minister himself that saved the day for them and they managed to survive the horrid times. They are at present, in the process of regaining their poise and composure.

However, to have a glimpse of the qualitative dimensions of the impressive upsurge in the activity on the Stock Exchanges, I propose to go a little bit deeper into some aspects of their character and functioning.

We have, at present, 14 Stock Exchanges out of which five have been established after 1978. A few more are expected to be established in the near future. At the end of 1986, 4,344 companies were listed on the Stock Exchanges, with a paid-up capital of Rs.6,074 crores, representing 90% of the paid-up capital of all non-government public limited companies. Their market capitalisation was estimated at Rs.21,077 crores.\* The Bombay Stock Exchange alone accounted for 70% of the overall listed capital in the country and 80% of the overall market capitalisation in 1985.\*\* Thus, what is happening in Bombay can be considered to represent the true picture of what is happening in the rest of the Exchanges, barring at best two or three. What is, therefore, described in this part of the lecture, also applies to most of the Stock Exchanges in the country.

The total volume of reported transactions (a number of transactions going unreported) is, at present, around Rs.12,000 crores in the Bombay Stock Exchange. Out of this total volume, transactions of the value of about Rs.11,000 crores are forward or speculative transactions, where there is no intention either to take or to give deliveries of shares. The balance of transactions involve deliveries of shares. Only about 3% of the deliveries, represents purchases or sales of securities by the genuine investors, the rest arising out of carry-forward transactions (budla) - Other

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\* Present position of the Stock Market in India -  
The Stock Exchange Foundation, Bombay - 1986.

\*\* Report and Accounts 1985 -  
The Stock Exchange, Bombay.

Stock Exchanges do not disclose, to my knowledge, the volume of their transactions. However, it may be estimated that the total volume of transactions, in all the Stock Exchanges in the country, would be around Rs.18,000 crores, with genuine deliveries (excluding those meant for carry-forward business) being around 8%, presuming that some of the Stock Exchanges may be having more deliveries on a cash basis.

There are about 2,200 stock brokers in the country, out of which only about 1,400 are active, rest being inactive and not doing any worthwhile business. It appears that in the Stock Exchanges of Calcutta, Ahmedabad and M.P., there are more inactive stock brokers than active stock brokers. Even in the premier Stock Exchange of Bombay not more than 50% of the stock brokers, numbering about 300, are active. It may be highlighted that out of 1,400 active stock brokers in the country, not more than 100, at best, may be considered to be 'fit and proper' in terms of general or professional knowledge, adequacy of education, skills in business, availability of infrastructure facilities, etc. to render any worthwhile integrated services to the investors. Out of this small category, quite a few enterprising ones have branched out in allied lines of business, like merchant banking, portfolio management, financial and investment consultancy, management of fixed deposits public issues, etc. Some of them have created a small network of agencies/correspondents at some important centres in the country. Increasing use of computers and micro-processors is also being made by some of them for processing applications in respect of new issues of capital and for investment analysis and research. Some of them are active in underwriting of new issues and some are publishing investment news-letters, magazines, etc. Some have even established close links with leading foreign merchant bankers, investment bankers and commercial banks, in advanced countries and are, at the same time, developing contacts in the under-developed countries. They are swapping information on companies, industries, investment opportunities, possibilities of collaborations, syndication of loans, etc. and are thus, getting good exposure, know-how and experience in international dealings. Unfortunately, such enterprising stock brokers are so few that one can count them on one's fingertips. By and large, many of the stock brokers are

<sup>e</sup>man of small means and do not have even sufficient resources to have elementary facilities like a telephone, a typewriter, a filing cabinet, adequate staff, office space, etc. A large number of them live on 'taravani' business. That is, they buy shares and sell shares which they do not have, on the same day or within a fortnight and settle differences in prices such transactions are not reflected, to my knowledge, in the volume of transactions published by the Bombay Stock Exchange. These stock brokers do not, normally, have much of outside business. They, however, do get business farmed out to them by big brokers or outside operators who often wish to hide their identity or want to evade payment of margins. More often, such stock brokers trade beyond their means and aggravate speculative tendencies in the Exchanges.

Majority of 1,400 active stock brokers hail from a few families, as most of the persons who are normally admitted to membership of the Stock Exchanges, are either close relatives of the existing members or their employees. Even today, many well educated, professionally qualified and competent persons who want to pursue stock-broking as a profession are denied entry into the business because of the inbuilt restrictive provisions of the Rules of the Exchanges and very high prices demanded by the existing members of the Stock Exchanges for the sale of their membership cards or shares.

The Stock Exchanges in India are speculation and not investment-oriented. Even the laws governing them place more emphasis on how to regulate such speculative transactions and protect the interests of the stock brokers than they do to protect the interests of the genuine investors. They handle a business of over Rs.18,000 crores per year, the Bombay Stock Exchange alone transacting business of Rs.12,000 crores per annum approximately, as stated earlier. Even these estimates are understated as a major part of the business is not reported. 90% of total transactions on the Stock Exchanges are concentrated only in about 200 to 250 active scrips (cash scrips are also carried forward) both in the specified and the non-specified lists of shares. They are speculative in nature and tantamount to sheer "gambling in differences", where no genuine deliveries of shares are given or taken. This huge



business is handled by only 1,400 active stock brokers in the country, 300 active stock brokers of Bombay alone commanding a business of about Rs.12,000 crores per year.

Normal functioning has recently become only a brief interlude between crises and stoppages of work, in most of the major Stock Exchanges in the Country. Malpractices like insider trading, rigging up of prices, creating false markets through spreading rumours, getting misleading information published in newspapers, option and kerb trading, manipulation of closing quotations of prices, etc. are rampant and have, unfortunately, become a chronic feature of the working of the Stock Exchanges. Even in case of some of the smaller Exchanges, apart from increasing evidence of malpractices, there are infightings, among rival groups, for controlling and dominating the governing Boards of the Exchanges, paralysing their working, in the process.

The Stock Exchanges normally work for only about 2 hours a day for approximately 150 to 200 days in a year. Substantial part of the transactions are forward transactions as stated earlier, and stock brokers earn more or less the same brokerage on such transactions as in cash scrips. A large number of them also trade on their own account. Hence, not much time is normally left for them on any given day to put through the transactions of the genuine investors to their best advantage and to attend to business in scrips which are less active. However, for the stock brokers who speculate and for outside operators there is a twenty-four hour trading in all the 365 days in a year, due to the facility of trading in option and kerb markets and share transactions, so effected after regular hours of trading, being allowed to be recorded officially as regular contracts, next day.

Each Stock Exchange follows its own trading practices and procedures in respect of (1) settlement of transactions (2) payment and delivery dates (3) closure of transfer books (4) marking of securities cum right/bonus/dividend or ex-right/bonus/dividend (5) fixation of margins (6) control over kerb and option trading (7) trading hours, etc. There is no co-ordination of such

practices and procedures at the national level, for making them uniform. Such an unco-ordinated approach tends to lead to considerable conflicts of interest, concealment of speculative transactions and perpetuation of other malpractices. Most of the times, what one Stock Exchange does, is undone by the other. Lack of pursuit of common policies in such vital matters come in the way of an evolution of a national securities market, proper regulation and control of all the Stock Exchanges, increased possibilities of arbitrage operations and excessive speculation by outside operators and some of the stock brokers. It may be noted in passing, that stock brokers of one Stock Exchange are not allowed to operate on their own in any other Stock Exchanges. They cannot have even branches to service their own clients in places where other Stock Exchanges are established.

The stock broking business is a legitimised monopoly business. The Stock Exchanges are, therefore, managed by their own governing Boards, constituted mainly of their own broker members. Most of the broker members of the Governing Boards are reported to lack foresight, national perspective or professional expertise to handle complex problems faced by the Stock Exchanges. Some broker members are not able to devote sufficient time to the affairs of the Exchanges as they have own businesses to attend to. Some of the enlightened stock brokers do not normally get a chance to be elected on the Boards because of the system of voting sanctified by the Rules of the Exchanges or because they themselves do not want to contest the elections to the Boards for one reason or the other. Outside directors on the Boards do not attend meetings regularly because of their other preoccupations and even when they do, they do not take keen interest in the affairs of the Exchanges.

It is, therefore, not surprising that the governing Boards of most of the Stock Exchanges, constituted as they are, at present, have proved, time and again, that they are incapable of running the affairs of the Stock Exchanges on sound and healthy lines by (a) controlling excessive speculation and other malpractices which have become endemic in the system, (b) monitoring the activities of the speculators effectively; (c) foreseeing the emerging crises and averting the same in time (d) establishing

effective reporting and audit systems or proper vigilance of grievance machinery; and (e) taking disciplinary actions against the stock brokers who often flout the Rules, Bye-laws, and Regulations and indulge in malpractices and indisciplined behaviour. Moreover, they are so engrossed with their routine work that they are not able to devote much time for other constructive work, such as planning and development of markets, adoption of modern methods for streamlining the operations of the Stock Exchanges, spreading investment knowledge and information among general public and safeguarding the interests of the genuine investors, without whom the Stock Exchanges can lose their socio-economic relevance.

The Stock Exchange authorities in the country generally complain of lack of resources to do other constructive work or even to provide sufficient infrastructure facilities to their members, like telephone and telex services, library and research facilities, proper office space and canteen facilities, visitors' galleries, etc. However, some of them are unable to persuade their own members to contribute more by way of annual subscriptions, membership fees or other dues, to strengthen the financial base of the Exchanges. To cite only one example, a recent proposal of the Calcutta Stock Exchange to step up the annual membership fee of only Rs.12 per annum to Rs.5,000 per annum per member is reported to have been opposed by their members on the ground that the same is a retrograde step !

In the ultimate analysis, it is essentially the close character of business; failure of self-discipline and self-regulation as the regulatory mechanism to govern their conduct; their primitive and outmoded system of functioning which has remained monopolistic in nature and practice; excessive speculation; lack of adequate resources of many a members to back up their commitments; and, the general lack of awareness among members of their socio-economic obligations which are at the root of many a failings of the Stock Exchanges, in becoming the most efficient financial intermediaries, for mobilising the savings of the community. It is, therefore, not surprising that even by 1989-90, investment in cooperative and corporate shares and debentures is expected to constitute only 5.7% of the net domestic savings, 2.8% of the financial assets held by the household sector and about 1% of the current national income.

Various attempts to reform the Stock Exchanges in the past have failed and they continue to remain the most loosely regulated and polluted sector of the organised financial system of the country, despite elaborate provisions of the Securities Contracts (Regulations) Act, 1956 and Rules, Bye-laws and Regulations framed thereunder, whose implementation is, incidentally, left to them only.

Unfortunately, even the Stock Exchange Division of the Ministry of Finance, Government of India which is supposed to supervise and control the Stock Exchanges is understaffed and over-burdened. With the best of intentions, sincerity and devotion to duty, it is not humanly possible for only a handful of persons to cope up with the work of fourteen Stock Exchanges in the country and to monitor and closely supervise their working. It has recently issued a number of directives to the Stock Exchanges to improve their working. Lot of publicity is also given to them. However, most of the directives so far issued, have touched upon peripheral issues without tackling the basic maladies afflicting the Stock Exchanges.

Even in the case of directives, issued so far, not much of follow up action and monitoring is seen to be done to ensure whether these are really implemented. No time-frame within which such directives must be complied with, is also indicated. Left to themselves, the Stock Exchanges may not be keen to implement them.

It is normally presumed that the Stock Exchanges provide liquidity, marketability and continuous price formation in case of securities. How far is it true of the Stock Exchanges in India?

The Stock Exchanges in India are extremely narrow, lack depth and are growing more and more illiquid, day by day, in a large number of scrips. A recent analysis on the frequency of transactions of equity shares on the major Stock Exchanges revealed that out of 3,401 listed companies studied in both "specified" and "non-specified" lists of shares, shares of 959 companies were traded once a year; shares of 954 companies were traded once a month; shares of 396 companies were traded

once a fortnight; shares of 538 companies were traded once a week and shares of only 207 companies were traded daily. Incidentally, these 207 shares are normally traded on a forward basis. If we examine the position of even the cash scrips on the most active Stock Exchange in the country - the Bombay Stock Exchange - a recent analysis by Shri R.R. Nair, G.M. of Bombay Stock Exchange (Research, Statistics and Data Processing)\* shows that during July and September 1985, out of 1,551 equity shares in the cash list (1) no trading took place, since listing, in 278 shares (2) only 792 were traded during July to September 1985; (3) 342 (i.e. 43% of active shares) were traded on less than 10 days ! and (4) only one was traded on all days !!

It may be mentioned that, this study did not include equity shares of 79 new or newly listed companies. The said study also reveals that 792 shares were traded during July to September 1985, 208 shares were traded during January to June 1985, 139 were traded in 1984, 134 were traded during 1983 or earlier and no trading at all took place in 278 shares. The position of liquidity of a majority of shares in Calcutta and Delhi Stock Exchanges may not be much different. If this is the position of the active markets, what about the position of others? It may be worse.

As for new issues, I quote no less an authority than Shri Amritlal Bajaj, Ex-President of the Delhi Stock Exchange, who reports in the issue of 'Money' for the week ended January 4, 1987, that 90% of the new issues which came in 1985-86 were unsaleable !

Thus, in an overwhelming majority of shares, quoted on the Stock Exchanges in the country, there is no worthwhile liquidity or marketability and if proper liquidity is there, it is concentrated only in about 200 to 250 scrips, particularly in scrips where forward trading, though banned in 1969, is permitted under the guise of specified list of shares which number only about 175 and in other active cash scrips which are carried forward in practice. Incidentally, these are also the scrips in which the institutions are mostly interested.

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\* Fortune India - February, 1986.

If this is the overall position of liquidity and marketability of equity shares quoted on all the Stock Exchanges in the country, where is the question of the continuous formation of prices for a majority of the listed shares?

The question may be legitimately asked for whom are we running the Stock Exchanges? One may also like to know what is the meaning of the impressive figures of a total volume of transactions of Rs.18,000 crores on all the Stock Exchanges in the country to a majority of genuine shareholders of a number of companies, who cannot sell their shares on the Stock Exchanges when they need money and, on whom and their like, we have to depend for mobilising the much needed resources for our economic development?

To my mind, the total volume of yearly transactions of Rs.18,000 crores in our Stock Exchanges has as little relevance and meaning to a shareholder of a company who has to use his certificate of unsaleable shares to wrap his eatables (Bhelpuri) as the figure of our G.N.P. or per capital income has to a footpath dweller who has no shelter or not much to eat!

The markets for other securities quoted on the Exchanges, such as (1) the market for securities of the Central and State Governments, local authorities, public bodies, etc. which is essentially a captive market; (2) the market for preference shares and (3) that of debentures, are more or less illiquid, in general, even though some liquidity is in evidence in the issues of convertible debentures.

With the increase in volume of transactions and more and more attention being devoted by the stock brokers to the speculative transactions which earn them more brokerage, with minimum cost and without much efforts put in, there are numerous complaints about deterioration in service to the genuine investors, and, therefore, considerable delays occur in effecting prompt delivery of shares and payments to the genuine investors. There are also other reasons for this. Most of the public limited companies do not realise their responsibility and take unduly long time in effecting transfers of shares. The system

of transfer of shares is equally to be blamed. These factors also make for more and more illiquidity in the markets and their growing inefficiency.

Yet another aspect which has a vital bearing on the functioning of the Stock Exchanges in our country, is their narrowness and the scarcity of floating stock of good scrips in the market. Such a scarcity of good scrips also flames the fire of excessive speculation. According to a recent study conducted by the IDBI, the shareholdings of joint-stock companies and that of the financial institutions, in the private sector were 31% and 27.3% respectively. Individuals holding more than 50,000 shares accounted for 18% of the total paid-up capital of the private sector. A major part of such holdings do not come up for trading in the market. With growing resources at their command, frequent purchases of large blocks of shares of mainly growth companies by the institutional investors from the markets, also lead to the scarcity of their floating stocks, particularly when their buying operations are more than their selling operations. Moreover, due to the inherently speculative character of the transactions taking place on the Exchanges, unrelated to the actual purchases and sales of shares, such a growing scarcity of good scrips combined with frequent placement of large purchase or sale orders by the institutions, without often taking into account the available quantity of shares to be purchased or the absorption capacity of the markets of the shares to be sold, often tend to increase volatility of the markets and open up possibilities for market abuses.

The primary market in the new issues of capital is, in recent years, (called the new issues market) is getting organised and diversified with the entry of merchant bankers, managers to issues and underwriters and registrars to the issues; planned publicity drives by companies; improvements in providing machinery for collection of applications through branches of the banks or opening of collection centres; increased use of computers for speeding-up the processing of applications, etc. are more and more in the nature of convertible

debentures. A major part of the fresh resources from the market is raised through the issue of debentures - mainly convertible debentures.

Unfortunately, some of the merchant bankers and managers to the issues and stock brokers, associated with the new issues of companies floated mostly by new entrepreneurs having little industrial background and uncertain past, unnecessarily resort to unscrupulous methods to grab business and ensure that the issues they manage succeed, at any cost. Their encouragement of and participation - direct and indirect - or connivance in widespread rigging up of premiums on shares before public issues, deliberate publicity of such premiums and exaggerated claims of good working results and better prospects in a short time are deplorable, to say the least. Such misleading representations have landed a number of investors (who invested their savings in new issues in good faith believing what they claimed was true) in dire straits, in getting their refunds and certificates in time and also in selling the shares allotted to them.

While such tactics may succeed for a while, they bring bad name to them and to their promoter clients and also do immense damage to the cult of equity which we have to promote in the country, if a sizeable part of the required resources for the development of the economy are to be mobilised by way of equity capital.

One wonders whether the above aspects of the character and functioning of the Stock Exchanges are signs of their sound health or of the onset of terminal illness. At least, there are increasing signs of "apoplexy at the top and anaemia at the bottom" and their landscape continues to be dotted with a number of question marks and few answers.

Such a distressing overall state of affairs in our primary and secondary markets, is neither in the interests of the genuine investors nor in the interests of the national economy or even in the interests of the stock brokers themselves.



(C) EMERGING SCENARIO \*\*

The growing resource gap in the economy, is now accompanied by a veritable scramble for resources by the public sector enterprises, regardless of yield and cost considerations and, declining trends in national savings due to, among others, growing consumerism. Such fresh developments themselves will post new problems to the Private Sector in raising a substantial part of the required resources from the household sector to fulfil its planned physical targets in the remaining years of the 7th Plan.

However, to visualise the magnitude and gravity of this problem in the years to come, till the twilight year of the present century, 1999-2000, I have tentatively arrived at certain estimates based on data available in published documents\* and certain simple assumptions. According to these estimates, other things remaining the same, the following scenario will emerge for the private sector. The implications of the same for the Stock Exchanges, if the present status-quo continues, are examined later.

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- \* 1. National Income, Consumption expenditure saving and capital formation. Quick Estimates 1985-86 Central Statistical Organisation.
2. 7th Five Year Plan - Planning Commission.
3. Economic Outlook - 1986 & India's Economic Growth 1950-51 to 1985-86. (June 1986) - Centre for Monitoring Indian Economy.
4. "Corporate Numbers Game" - Shri Ram K. Piparaiya & Mr. R. Agarwal.
5. Present Position of the Stock Markets in India - The Stock Exchange Foundation, Bombay 1986.

\*\* This entire exercise is done only with a view to seeing what sort of picture emerges by 1999-2000 even on the basis of simplest assumptions. It should not, therefore, be taken as authoritative but tentative.

The Private Sector will have to raise fresh resources of the minimum order of Rs.60,000 crores from the capital market between now and the year 1999-2000, making an average of about Rs.4,300 crores per year. Out of the total estimated resources, Rs.36,000 crores may be raised through debentures or debt-related instruments which may be quoted on the Stock Exchanges and Rs.24,000 crores may be mainly by way of equity capital, preference capital raised, at present, being negligible at less than Rs.2 crores.

The scenario which emerges by the year 1999-2000 from the above tentative exercise is, itself, daunting but it has its bright side too. Some of the aspects of the bright side are highlighted, hereunder :

1. In recent years, a remarkable change in the investors' psychology is evident. Investment consciousness is becoming more and more widespread and the investors' preference for financial assets as compared to physical assets, is growing.
2. The Government is now more open to welcome, among others, portfolio investments by non-resident Indians.
3. The Unit Trust of India has already floated the India Fund for attracting savings of the non-Indian Residents and others for investment in India. Similarly, the Government may permit, subject to certain conditions, formation of mutual funds/unit trusts abroad by the entrepreneurs in the private corporate sector. Some applications, in this respect, are already submitted to the Government and they are awaiting clearance.
4. It is reported that, on the basis of the Vaghul Committee's recommendations, RBI is now favourably inclined to permit well-established companies to issue money market instruments like short-dated commercial paper, subject to certain conditions. Secondary markets in such paper may develop. Such other money market instruments, like bill discounting, may be permitted to be issued later.

The IDBI has established a Venture Capital Fund to promote new technology ventures and a Stock holding Corporation.

5. The Unit Trust of India has floated a mutual Fund type scheme of master shares for the benefit of small shareholders in the country. Other schemes may be in the offing.
6. Recently a news item has appeared in the press to the effect that the Government is contemplating to relax debt-equity ratios in a number of industries. If this turns out to be true, this will enable companies to have better manoeuvrability to have an appropriate mix of debt and equity, consistent with their earnings and financial viability.
7. The Government is pursuing realistic policies in opening up of the economy in a number of areas. This is bound to get reflected in a more efficient and profitable working of the public and private sector enterprises, over a period. The Government is also receptive to new ideas and suggestions to improve the working of the economy. There is, therefore, no reason why pursuit of such pragmatic policies and approaches will not continue hereafter, at least so long as the present Government is in power. Once the political situation in the country improves and infrastructural bottlenecks eased, the tempo of the economy is bound to pick up further, resulting in better outlook, better psychology and prospects for more mobilisation of resources.
8. The Government is making serious attempts to tone up the efficiency of the public sector enterprises in order to improve their profitability and to reduce their draft on the national Exchequer. If these efforts meet with success, their need to raise more resources from the household sector may decrease to that extent.
9. Moreover, a vast potential of domestic savings of the household sector in the interior of the country remains to be tapped. It may be worth noting that nearly 65% of the existing shareholding population hail from only five centres - Bombay, Delhi, Calcutta, Ahmedabad and Madras - in the case of 80 large companies and that semi-urban towns with a population of less

than one lac has rather insignificant shareholding population, according to a sample survey done by Dr. L.C. Gupta. The picture is also not much different in case of new issues of capital where nearly 50 to 80% of applications with 50% to 60% of application moneys come from the main centres in Maharashtra, Gujarat and Delhi regions. It is, thus, evident that a lot of savings exist to be tapped even in other urban and semi-urban areas in the country, without even talking about rural side.

10. The primary market is more activated and better organised now, than at any time in the past, and lot of expertise, organisational abilities and sophistication is built up in marketing strategies, ignoring for a while, unethical practices which has crept in. An encouraging trend which has emerged is cares for them and wins their confidence.

11. The Government has announced its intention to improve the working of the Stock Exchanges and to provide additional incentives to activate the capital market to make it a more effective intermediary, to mobilise savings.

Thus, the emerging scenario opens up good prospects for mobilisation of required resources by the private sector, inspite of competition from other agencies and other environmental constraints faced by it. It is, of course, true that there is no room for self-complacency and inertia. The private sector will have to use all its innate resourcefulness, inventive genius, organisational abilities and devise appropriate marketing strategies to raise required resources from the household sector.

As for the Stock Exchanges, other things being equal, the emerging scenario by 1999-2000, will have frightening dimensions, particularly when they are not functioning well and are not able to manage their affairs satisfactorily, at present.

It is earlier mentioned that the Private Sector may have to raise, between now and the turning of the present century, Rs.60,000 crores, from the capital market, and

that out of this Rs. 36,000 crores may be in the form of debentures and debenture-related instruments and Rs.24,000 crores may be in the form of equity capital.

1. Assuming that 90% of the paid-up capital of all the public limited companies will continue to be listed on the Stock Exchanges in future, the Stock Exchanges may have a minimum of additional 7,000 to 7,500 companies listed with them, making a total of about 12,000 to 12,500 listed companies with a total paid-up capital of around Rs.30,000 crores and market capitalisation of about Rs.90,000 crores by 1999-2000.
2. Eventhough, according to Mr. Malcolm Adisheshiah, the investor population may be in the region of 50 million by then, I presume that the same would be atleast between 15 to 20 million, excluding multiple accounts.
3. The number of Stock issues of listed companies may be around 10,000 to 12,000.
4. There may be around 600 new issues at least every year.
5. The total volume of transactions may be of the order of Rs.75,000 crores for all the Stock Exchanges in the country, with Bombay alone handling about Rs.60,000 crores. The total transactions in the forward markets of all the Stock Exchanges could be at least of the order of Rs.68,000 crores (assuming that speculation will be permitted to continue on the present scale) and there would be cash deliveries of about Rs.6,000 crores (excluding deliveries involved in badla). For Bombay alone, the transactions in the forward market would be Rs.55,000 crores with actual cash deliveries in the region of Rs.2,000 crores and the rest being for badla transactions.

6. The actual number of individual transactions may be around 50 million.
7. It is assumed, to be on the safer side, that only 10 million out of 15 million investors will require the services of stock brokers by 1999-2000 and each stock broker will be able to service about 1000 investors. On this assumption, all the Stock Exchanges will require a total membership of at least 10,000 active stock brokers with a wide network of sub-brokers and agents as against 1,400 only at present. The Bombay Stock Exchange may require around 2,500 active stock brokers as against 300 as at present. If Mr. Malcolm Adisheshiah's estimates prove correct, I do not want to make a guess but wish all the Stock Exchanges well !

You will feel that I have indulged in a number-game which has now become a national pastime. I can, however, assure you that it is not a bogus but a fairly conservative picture. I have taken pains to get it verified by one of the most knowledgeable persons in the stock exchange matters.

(D) RECENT TRENDS IN THE STOCK EXCHANGES ABROAD:

It would be appropriate, at this stage, to have a broad view of the traumatic changes and the trends evident in the Stock Exchanges in advanced countries to realise where we stand and the lessons, if any, we can draw from them, for our benefit.

The Stock Exchanges, the world over, are recently undergoing significant transformation in the wake of metamorphic changes in the national financial markets. The opening up of the national economies, particularly in the field of international trade and payments; financial deregulation; revolutionary changes in computer technology and telecommunications; structural reorganisation of the money and capital markets;

removal of restrictions on the free flows, across the national boundaries, of industrial securities, financial instruments, moneys, etc. are providing new challenges to the Stock Exchanges.

Numerous pension and provident funds, insurance companies, mutual funds, commercial banks, money managers, etc. who have massive funds, are now eagerly hunting for suitable outlets anywhere in the world, where the markets seem undervalued. Revolutionary changes in telecommunications and computer technology, mentioned earlier, have made it possible to transfer billion worth of currencies for investment in shares, money market instruments, bonds, etc. in other countries, with the blink of an eyelid, by just pressing a button. Side by side, there has been a spectacular growth in the number of computer-aided and financially powerful firms of financial and investment consultants, investment bankers, arbitrageurs with huge financial backing, investment boutiques, etc. They compete fiercely to provide to investors with a range of financial services, including selection of portfolios, market intelligence on companies and industries, both at home and abroad, analysis of market trends, choice of mutual funds and other forms of investments, opportunities for mergers and amalgamations etc. Even complete software of investment programmes for one's own personal computer to suit one's varying needs and a full range of house-broking and tele-broking services are now being gradually introduced through electronic linkages.

Partly in consequence, increasing financial innovations are being undertaken by specialists. This has led to growing securitisation of debts and devising of new financial instruments for different types of investors - individual, institutional or otherwise - around the world, to suit their considerations of safety, security, yield and appreciation on capital. The options and future markets are also springing up in different countries.

Growing possibilities of massive inflow of resources from abroad to supplement domestic resources and closer coordination and integration of domestic economies for their sustained growth are, in turn bringing about radical changes in the national psychology and outlook towards foreign capital. The Governments concerned are actively encouraging fierce competition in their domestic markets, by permitting foreign nationals, commercial banks, merchant bankers, investment bankers, conglomerates, etc. to transact business in their securities markets either on their own or through collaborations or mergers with local securities firms of brokers and to share the ownership of capital of domestic companies. This has, incidentally, helped in improving their efficiency and in reducing dealing costs. All these developments have led to substantial foreign investments in industrial securities and money market instruments, in a number of domestic markets. It is reported that over 50% of the total volume of trading in the London Stock Exchange now takes place in foreign shares. The American Investors bought nearly \$ 40 billion worth of foreign shares and securities and even the conservative Japanese investors, who do not normally like to invest abroad, invested about \$ 6 billion dollars in foreign shares in 1985. New issues of shares are distributed on a global basis by syndication of banks and even the under-valued markets like Sweden, Denmark and host of such other markets are getting increasing intention of foreign investors. It is reported that dealings take place in about common 500 shares in different markets, over-the-counter. In such a background of developments, century old traditions, restrictive trade practices, feudal privileges and **vested** interests of the local stock brokers have been abolished in these markets.

Forgetting the past, every one concerned is now speeding up the process of adjustments to the new changes in a smooth and orderly manner and to face challenges implicit in the competitive environment emerging from growing



globalisation of the financial and equity markets and twenty-four hours trading.

Simultaneously, to win the confidence of the foreign investors, each nation is trying to streamline its settlement systems, tax laws, accounting standards and disclosure requirements to ensure quick buying, selling and transfer of securities and to effect prompt payments related thereto. Penalties for security offences like insider trading, fraudulent representations, misappropriations, manipulation of markets by rigging or otherwise have been stiffened upto 7 years' imprisonment. Fines imposed for malpractices run into millions of local currencies and the offenders are also required to repay to the authorities three times of profits made or losses averted by them by their deliberate manipulation of the markets and other malpractices when they are caught.

Considerable buoyancy is witnessed, in recent times, in a number of Stock Exchanges abroad, due to, among others, privatisation drives in some countries, amalgamations, take overs, etc. particularly in the U.S.A., investment of sizeable funds by institutional investors in foreign markets, better outlook of the economy and transmission of buoyance trends to other markets, in sympathy.

At the same time, the growth of the options and future markets with linkages with regular markets and the computer-aided programme trading of massive parcels of different types of securities by institutional investors, are leading to wild fluctuations in prices of shares and securities in these markets. The national governments and the Stock Exchanges are, therefore, keeping a close watch on the constantly changing situation and are refining their techniques of regulation and control. They are also busy with working out informal bilateral understandings and even agreements to exchange information on a global basis relating to security transactions and to collaborate with each other in tracking down security frauds and other offences. Moreover, loopholes in regulatory techniques and in the existing laws on investors' protection are plugged and strengthened further, wherever necessary.

Such breathtaking developments and emergence of new trends, leading to increased volatility or instability in the major Stock Exchanges and the financial markets, are naturally causing serious concern and anxiety to most of the investors abroad. A growing number of investors are, therefore, increasingly seeking safe havens in 'packaged investments' offered by insurance companies, mutual funds, unit trusts, etc. to protect their savings and earn safe but reasonable returns thereon.

### III. THE CHALLENGES AHEAD

In this part, the challenges implicit in the emerging scenario by 1999-2000 in a few areas of the new issue market and those of the secondary markets (Stock Exchanges) are examined. Some lines of action or the fresh thinking required to meet the same are indicated, wherever necessary. It has to be said, at the outset, that each task to be performed will itself be a challenge and meeting of each challenge will require implementation of the steps suggested. Hence, overlapping, if any, between the two cannot be avoided. The subject can be examined separately for the new issue market and for the secondary markets (Stock Exchanges).

#### THE NEW ISSUE MARKET - SOME RELEVANT ISSUES:

The success of the new issue market is very crucial for raising maximum resources for the diversified growth and development of the industrial sector of the country. The main challenge is to raise the required resources upto 1999-2000, from the new issue market on a continuous basis from now onward. The other is to devise appropriate strategies and take positive policy decisions to induce the investors to continue to invest in new issues in the face of alternative investment avenues, including physical assets, which appear to them more attractive and safe.

As stated earlier, the private sector will have to raise resources of an approximate order of Rs. 24,000 crores by way of fresh issues of equity capital and cumulative convertible preference share capital from the capital market between now and the year 1999-2000, i.e. an average amount of about Rs. 1,400 crores per year from now on as against an estimated Rs. 1,100 crores as at present. As the instrument of cumulative convertible preference shares is stillborn, not much mobilisation from it can be expected. About 600 net issues will also come to the market every year.

So far as raising of resources, by way of right issues of existing companies is concerned, there may not be problems except in case of companies with indifferent working which they will have to improve, in any case, if they want to raise fresh resources from their shareholders.

The story of 'green field' ventures is different. It will be difficult to raise fresh equity capital on the required scale in future in the light of our recent experience unless we change our method of raising resources by way of equity from the capital market, think on new lines and tackle a few other problems, which have surfaced lately.

These issues are examined hereafter.

90% of the new issues made in 1985-86 are unsaleable, as stated earlier. Such has been our experience in the past also. Thus, though the chequered history of the new issue market keeps on repeating, we do not do any fresh thinking on the subject and keep on repeating past mistakes, stultifying the growth of a vibrant capital market, in the process. Now that more and more resources will have to be raised from the household sector should we not think on new lines or take corrective action to resolve some acute problems faced by the investors?

All the issues below Rupees one crore do not, now, require the permission of the Controller of Capital Issues. They form quite a large number of new issues made. There is not much of expertise or proper machinery for appraising or evaluating the technical or financial aspects of the proposals either with most of the merchant bankers, Registrars of Companies, the Stock Exchanges or others to look critically at the proposals

from all angles. Similarly, there is no proper audit of accounts or management audit of the capabilities and quality of management of such ventures. Many a sub-marginal companies in this group are growing like mushrooms and making 'junk' issues in the market and will be doing so, in future. Necessary guidelines stipulating essential preconditions such as minimum promoters' contribution audit of accounts, management audit, report on technical feasibility of the project, etc. for making public issues should be urgently prescribed to protect the interests of investors and keep their interest alive in the new issues by way of equity. If this type of 'junk' issues are allowed to be made now and investors are ruined - would it not be better to allow formation of venture capital companies security houses or investment banks on a selective basis, by private entrepreneurs who are prepared to take risks and who can create necessary machinery for evaluation and appraisal of projects, provide necessary managerial and technical inputs, and, if satisfied, can nurse the issues for sometime, before offering them to the public? Should we not also think of formation of a subsidiary by the financial institutions whose function is to promote industrial development jointly with the two Insurance Corporations, whose function is to take risks, and the nationalised banks which would be interested in the new accounts? Formation of such an institution can be on the lines of issue houses or investment banks abroad which nurse new issues till they are seasoned i.e. till they come to production or breakeven stage and then sell the same to the public. It can also offer a package of other services to investors. The cost of making public issues will also be substantially reduced, and the capital market will become ~~more~~ <sup>let</sup> healthy.

In no other country, to my knowledge, the investors are directly exposed to undue risks of new 'green field'

ventures and should not, in fact, be exposed to, particularly in underdeveloped countries, where they do not have either the required knowledge or expertise in the intricacies of investment matters or about the technical aspects of trading in securities and are generally misled by unscrupulous elements.

The unethical practices practised, recently, by some of the merchant bankers, managers to the issues, stock brokers and promoters are a case in point. They have disillusioned investors and have not only done an irreparable damage for their own selfish interests, to the cult of equity but also to the role of the capital market as mobiliser of savings. There should, therefore, be proper legislation to regulate the functioning of all the agencies connected with the marketing of the public issues so that such malpractices are stopped.

We have no objective criteria to judge what damage we have done to the growth of the capital market in the country till now, by following all these years, the practice of offering shares of new companies to the investors before they start even the constructive work and have plant and machinery installed and to know how many investors have shied away from investing in new equity issues because they have burnt their fingers in the past. Till policy decisions in such matters, as indicated earlier, are taken, should we not at least have fresh thinking on the question of reordering of our priorities of financing of new projects wherein the financial institutions and banks participate? The new companies require the funds for their projects in a phased manner, on an average, for about three to four years, to come to the production stage. As suggested by someone, promoters can bring in their contributions first, institutions and banks can then come in to the

extent of their commitments and thereafter for the balance amount required in later years, the companies can approach investors so that the gestation period is reduced and they have not to wait long for return on their investments. This type of approach in project financing will inspire confidence of the public in the new issues and will evoke better response from them for the new issues of capital in future. Thus the capital market, will, by itself, get activated. After all, the financial institutions and banks agree to finance the projects only after they get the projects thoroughly vetted and are satisfied about their viability from all the angles and the promoters' abilities and competence to carry out the project successfully over a period. They are also secured by mortgage of assets and by personal guarantees which are not available to ordinary investors in the new issues.

In such a context, why should we treat the investors as 'sacrificial goats' and expose them from the beginning, to great risks of depreciation of their capital and the loss of returns for a long period and thus, penalise them for investing their hard earned savings for the industrial development of the country. I, therefore, agree, with others, that the promoters and the institutions should come first in the projects before the investing public does. The problems, if any, arising out of such an approach can be sorted out, if the will and concern is there to do so. Unfortunately, the general tendency in many of our institutions and the Government Departments is to scuttle new ideas even if they are feasible by preparing beautiful position papers highlighting their negative aspects rather than the positive ones and the steps required to implement them. If such a fresh approach is adopted it will also lead to a much closer monitoring of the projects by the financial institutions and greater discipline in resource use by the companies concerned, in the initial critical stages of the new projects, which the

individual investors are not in a position to ensure. It will also improve performance of a number of new ventures and prevent undue escalation in costs and their incipient sickness. Fresh thinking in this matter will itself pose a challenge. In case we continue the present method of raising resources required by the new ventures in our traditional way, despite the fact that it has done a lot of harm to the growth and development of the healthy capital market, we shall have to resolve, at least, some of the present problems of the new issue market.

One of the challenging problem areas, is the cost of public issues, which has sky-rocketted recently. The new companies cannot afford to raise resources at such heavy cost particularly, when more mega-projects would come to the markets, in future. These costs must be reduced and the Government should not succumb to any pressures from any quarters in this matter and should even withdraw their earlier circular on mandatory cost for further consideration as the question does not seem to have been properly examined. Financial institutions and the investment institutions should also, on their own, come forward and charge lower underwriting commissions, which form a substantial part of the cost of the public issues, as a part of their social obligations in cases where they underwrite the issues. May I humbly ask how does it help them except to show higher income in their balance-sheets as against which they have to finance, ultimately, increased cost of the projects? In any case, they are expected to set examples to others. The institutions should also impose certain disciplines on the managements of the companies who approach them for assistance, so that the cost of the public issues is reduced. Their nominee directors on the Boards of the Companies should look closely into the matter and satisfy themselves about the reasonableness of the cost.

There would be about 600 new issues of capital to the public by 1999-2000. A tremendous burden will be imposed on the postal and telecommunication systems. The authorities concerned will have to plan in advance to cope up with the problems which may crop up, in future. However, the important questions of speedy clearance of applications and refunds of amounts to the investors will be required to be looked into. As for the speedy clearance of applications, the need for a number of computer agencies for processing applications, right upto the stage of allotment, will considerably increase. The banks will also have to gear up themselves and improve their efficiency and the companies concerned shall have to plan properly to allot the shares and issue certificates promptly. At present, a number of problems of coordination crop up and conflicts of interest arise among different agencies and this leads to delays in processing of applications and issue of share certificates. Close monitoring of the whole processing machinery is also normally absent. The whole mechanism of the market can work smoothly and efficiently only if every agency involved realises its responsibility to the capital market and plans in advance. In this context, quick refund of application moneys to those investors who are not allotted shares has become a grave issue and poses a challenge to our thinking. The Indian Banks Association and RBI should reopen this issue and reconsider the suggestion of pre-paid security cheques. Simply reacting in a negative way by saying that the suggestion is impractical is not a solution to the problem. They should then suggest an improved version of the same or a better alternative. If the banks cannot do this, the Government should suitably amend the provisions of the Companies Act, 1956 regarding the deposit of application moneys in a separate account with a bank in case of public issues and follow the practice of the U.K. where it is reported that the cheques of those investors who are not allotted any shares are returned without encashment. If this can be done elsewhere, can we not do it?



Some of the provisions of the Companies Act, 1956, have also a bearing on the subject. For example, all the provisions of the Companies Act, 1956, pertaining to the new issue of Capital such as the form of the prospectus, requirement of prospectus to be sent with application form to each prospective investor by the companies, necessity of issue of allotment letters, etc. have become archaic and otiose. We should simplify the legal formalities and procedures connected with the issue of new shares till the stage of the issue of certificates so that there may be faster completion of issues and a lot of inconvenience to everyone can be avoided and costs of issues can be reduced substantially. The prospectus is too legalistic in nature and is of limited utility to an investor. It should be made simple and contain details, in brief, which are relevant from the point of view of investors. The Company Law Department should seriously look into such matters and do the needful in consultation with the Institute of Company Secretaries and the Institute of Chartered Accountants or other concerned parties. The private sector may also have to raise resources from the capital market by way of debentures or debt related instruments of the order of Rs.36,000 crores by 1999-2000, i.e. of the order of Rs.2,650 crores per year as against Rs.2,300 crores raised on an average in the last three years, including 1986-87. It can be assumed that the investment institutions, Army Fund and investors - particularly in convertible issues - will continue to contribute their might. However, with issues of bonds in substantial amounts by the public sector units with lot of attractions, the interest of individual investors appears to have recently waned in such issues. It would, therefore, be fair to give some more tax concessions to those who may like to invest in non-convertible debentures for safety and yield considerations. Government may also consider allowing public provident funds to invest a part of their funds, on a selective basis, in public issues of debentures to improve income of such funds and also to lend some

token support to the debenture market. Moreover, the Government and the R.B.I. should permit issues of debentures by the Companies with varying rates of interest, subject to a ceiling, of 15% with 5% premium at the end and with differing maturities between 5 to 12 years. It is not proper to treat all the companies alike and make them issue debentures on the same terms and conditions, without taking into account their working, financial strength, image with the public etc. The public should be allowed to decide whether they prefer such issues, if the company so desires to issue at a rate and maturity within the limits prescribed, considering their ability to service and redeem the debentures. Great care will have, however, to be exercised to ensure that this does not lead to the "perils of increased leveraging" and corporate debt trap.

In this context, the Government should also seriously consider allowing the companies to issue warrants along with their non-convertible issues, bearing lower rates of interest, which can entitle the holders of such debentures to equity shares at certain fixed price and at a certain future date. This would reduce the interest cost to the companies and also activate the debenture markets. Till the shares are issued, the holders of debentures with warrants, would get no return on warrants apart from appreciation in their value, but will continue to get interest income on the debentures they hold. This new instrument can also help revive interest of the investors in the non-convertible debentures. Issue of such an instrument is common abroad.

Thus, the stock exchanges would, incidentally, have more instruments to trade in.

#### THE SECONDARY MARKETS (STOCK EXCHANGES) - Some Relevant Issues:

The extent of the enormity of the tasks to be performed by the secondary markets (Stock Exchanges) by 1999-2000, can be gauged by the following facts, among others. The Stock Exchanges will have to handle about

- (1) 50 million transactions in a year,
- (2) the volume of transactions would be more than Rs.75,000 crores in terms of value (about Rs.68,000 crores will represent forward trading if the speculation continues to be carried on),
- (3) genuine transactions will be of the value of about Rs.6,000 crores, (4) the number of companies will be around 12,000 to 12,500, (5) the number of shareholders i.e. investors, would be 15 million to 20 millions and (6) the number of new issues will be around 600 per year. These will be listed later, on the Stock Exchanges.

The present unsatisfactory state of affairs in the Stock Exchanges has been, mainly, the result of the accumulated neglects of the past. Hence, the challenges which we talk about will be essentially in the realm of our fresh thinking on the subject.

Other formidable challenges will be to our intellectual honesty to face the facts as they are and sincerity of purpose and resolve to tackle the problems, without adopting 'soft options' and allowing the situation to drift from bad to worse. What sorts of other challenges and tasks we have to face, and problems to be resolved, in case of the Stock Exchanges if they have to justify their existence and fulfil the tasks ahead?

The biggest challenge to be faced in this market is to make the Stock Exchanges safe for genuine investors who hold the 'key' to our planned economic development. This can be met to a great extent if we control excessive speculation in the Exchanges.

The fundamental issue which we try to evade and which leads to ambivalence in our thinking and policies relating to the Stock Exchanges is to decide whether we need so much of forward trading - which was banned in

1969, and is now revived - under the guise of hand delivery transactions in specified list of shares, where transactions are allowed to be carried on almost in perpetuity through the renewal of contracts and payment of contango charges. Nearly 90% of the trading on the Stock Exchanges is sheer "gambling in differences" as the speculative activities permitted to be carried on in our country have no backing of either the intentions to take genuine deliveries of shares which are purchased or to give deliveries of shares which are sold.

Speculation does not mobilise any fresh savings or leads to any asset formation in the industrial sector. It provides real liquidity in case of only 200 to 250 active shares in the markets where, at present around 5,000 shares are listed. Thus, the primary purpose and very relevance of the Stock Exchanges to provide liquidity and easy marketability or quick payments for deliveries effected in respect of shares is not served in about 90% of the shares, on the basis of continuous price formations. It leads to all sorts of malpractices also, including extensive insider trading, manipulation of markets, evasion of taxes, generation and proliferation of black money and above all to frequent crises and growing instability of the markets. It wastes a lot of time of the Stock brokers in such transactions, leaving little time for them to attend to the work of genuine investors. Perhaps, there may have been some justification for such speculative activities in the early stages of the development of the equity markets to create interest among investing public about investment in shares, but even then it was normally backed up by underlying securities and intentions to take delivery of shares. Now that our markets are well established and have gained maturity and experience, when the public has become more and more investment conscious and when the primary markets can give good response to good issues without rigging up of prices, do we need such excessive speculation?

Even without such excessive speculation, there can be buoyant conditions in the Stock Exchanges based on the individual performance of the companies and the increasing demand from genuine investors for good growth scrips in general. What we really need is real resources to be raised for accelerating the tempo of development and not provide 'casinos' to the speculators and operators at the expense of the national economy and genuine investors, without whom the Stock Exchanges will have no function to perform. The most serious aspect of permitting such excessive speculative activities is that even the younger generation and other new investors who have, increasingly, started taking interest in the Stock Exchanges, are developing 'casino culture' instead of 'investment culture'. Such a development may have serious consequences for the country's future development. Ultimately, who benefits from such speculation? Excessive speculative activity and contrived buoyancy and volatility in the Stock Exchanges shake the confidence of the genuine investors in the Stock Exchanges and actually prevent the healthy and vibrant growth of the capital market.

Lord J. M. Keynes has warned that "the position becomes serious when enterprise becomes a bubble on the whirlpool of speculation and when capital development of a country becomes the by-product of the activities of a casino". This is exactly what is happening in our new issues market and in the secondary markets (Stock Exchanges) and we must prevent it.

Even if we feel that some speculation in shares is necessary and permit it, why do we shy away from strictly limiting its dimensions so that frequent crisis do not occur, malpractices are reduced and the stability of the markets is not threatened, now and then? Why have we to depend only on the institutions to salvage the markets, often? We must create built-in stabilisers for such situations in the markets like general backing of moneys and securities, to meet such situations.

The following actions must, therefore, be taken on an urgent basis even if we want forward trading to continue. It may, however, be mentioned that we have not yet removed the legal ban on such transactions, though they are carried on and permitted unofficially. The following main actions, among others, must be taken to curb excessive speculative activity :

1. The present regulatory mechanism is not satisfactory. We must introduce immediately the system of front-end margins of a minimum of 30% to 40% for forward sales or purchases of shares or even 100% in case of emergencies. Genuine investors who want to purchase shares would not mind paying in advance such margins or deliver the securities when they are required. In no other country, to my knowledge, such rampant speculation is permitted without such margins or without the backing of moneys or shares. The margins so taken from each person who wants to speculate must be collected in advance, proper records must be kept and the amounts collected must be deposited with the Stock Exchanges in a separate account of the stock brokers on behalf of their clients.
2. No speculation should be allowed in shares for more than a maximum period of one month. There should be separate contracts for such transactions in a different colour and the validity of such contracts must be limited to one month. Such contracts would thereafter become null and void. No transactions would be allowed to be carried forward by paying budla and issue of fresh contracts. Such contracts must be settled at the end of the month either by payment of differences in cash or by taking or giving deliveries of the shares, as the case may be.
3. The regulatory mechanism, the reporting system the audit and surveillance machinery shall have to be

tightened up to ensure that each stock broker involved, reports such transactions faithfully and complies with the directives issued by the Stock Exchange authorities. Any infraction of such requirement should invite strict penalties, including heavy fines, suspension from business for at least 3 months and even expulsion from the Exchange.

4. Certain practices like insider trading, manipulations of the markets and other malpractices having a tendency to disrupt normal working and/or destabilising the markets must be curbed by severe penalties including severe fines upto three times the profits made or the losses averted and also imprisonment upto at least 7 years, as is now done in the Stock Exchanges abroad.

Incidentally, press reports have appeared to the effect that the Government intends to bring forward legislation to control "insider trading". It has to be emphasised, in this context, that the Sachar Committee's recommendations are not adequate for the purpose. In cases of 'insider trading' shares are generally taken up only on a forward basis and nobody normally wants to spend money and take the delivery and gets the shares registered in his/her name. Such contracts should also be covered under the proposed legislation. Moreover the coverage of relatives is limited in case of Sachar Committee's recommendations. The High Powered Committee on the Stock Exchange Reforms has given a draft of the proposed legislation to the Government which, I believe, takes care of the loopholes. However, apart from taking note of these factors, the proposed amendments to the Securities legislation in the U.S.A. to tighten the provisions to control 'insider trading' should also be noted.

5. The business done by each stock broker as an agent and on his own account must have definite relationship with the resources he employs in business on the Stock Exchanges. He should not be permitted to trade beyond certain limits related to his means.

If he does this often, he must be expelled from the market. A system on the lines of liquidity margins abroad may be introduced in our country.

6. There should be frequent exchanges of information among the leading Stock Exchanges about the large purchases and sales effected in the local markets by any party to build up market intelligence and to know the extent of intra-exchange speculative build-up by operators.
7. There should be a proper code of conduct for all the stock brokers which must have legal sanction. If anyone violates the same, he should be ostracized by other stock brokers and penalised.
8. The stock brokers called "Taravaniwallas" must be asked to maintain proper books of accounts. Their books must be subject to audit to find out farming out of orders by others to evade margins or to hide the identity of the operators. I am informed that in the last few major crises, in the Bombay Stock Exchange, at least 100 stock brokers were involved, every time.
9. The scrips in which the institutional holding together with that of the promoters exceed 60% should be taken off the 'specified list'. The institutions themselves should sell the shares they hold if their combined holding goes beyond 40%.
10. Lot of rigging of prices in shares before their issues take place in areas where there are no Stock Exchanges. The mushroom growth of road side associations of brokers which has also taken place in such places, essentially for the purpose of speculative trading or for farming out of business from other centres must be declared illegal. Such associations do more harm than good to the cult of investment in financial assets. It should be provided by law that nobody shall be permitted,



anywhere in the country, to deal directly or indirectly in securities listed or proposed to be listed on the stock exchanges, without proper registration and authorisation. The relevant provisions of Securities Contracts (Regulation) Act, 1956, should be amended accordingly. // If we succeed to curb excessive speculative activities, we shall win more than half the battle in meeting the challenges faced by the Stock Exchanges.

Investors normally prefer to invest in good scrips. The healthy state of the market cannot naturally depend only on 200 to 250 scrips. The scarcity of good growth stocks is one of the causes of limited nature and narrowness of our markets and leads to concentration of speculative activities on a few shares leading to instability of the markets. It is, therefore, necessary that wide spectrum of instruments should be made available to the investors to choose from and enable them to switch over from one to the other. This will not only improve liquidity in the markets, but also broaden them. The following suggestions, in this connection, may be considered.

- (1) The private limited companies with good track record which avail of finances from banks and institutions beyond certain limit, should be persuaded to broaden the ownership of their capital by giving them necessary exemption of capital gains and permitting them to make offers of sale upto 25% of their capital to the public at reasonable prices. In this connection, the option given to the promoters to disinvest is welcome, but more requires to be done.
- (2) The question of issue of non-voting shares for both domestic and non-resident shareholders deserves serious consideration.
- (3) To make it easier for the companies to issue more equity capital, can we also not examine the

question whether we can allow existing public limited companies to offer 25% of their shares directly to the public as is proposed recently by the Chancellor of Exchequer in the U.K. if the companies can service the enlarged capital? In such cases, we have to amend the provisions of the Companies Act, 1956, which require a special resolution from the existing shareholders, for increase in capital.

- (4) The L.I.C. and the G.I.C. should not only purchase but also sell the shares in the markets more often. The continuous purchases of shares by these institutions from the markets without frequent selling of shares by them lead to the scarcity of good shares in the markets and also aggravate price rises unduly. If they also sell shares frequently, it would improve the liquidity in the markets. If restrictive provisions of taxation come into the picture, they should be liberalised. The restrictive provisions of the Insurance Act framed years back and which were meant to govern the activities of the private sector companies and which still govern their operations to a large extent, must be amended so that they can actively participate in the development of the new issue market and bring about some discipline, therein.
- (5) The Chiefs of the public sector undertakings have approved partial privatisation drive and offer of the shares of their companies to the public and the employees of the public sector undertakings. This suggestion is worth considering by the Government in case of companies with good track record. It will release the resources of the Government and also help the markets. If the Government does not wish to adopt this approach, the shares may be offered to the public sector investment institutions, with suitable guidelines as to voting rights, etc. This will not only release the resources of the Government but also provide these institutions with more investment outlets.

- (6) Allowing the companies to issue warrants and debentures with varying maturities and yields have been discussed earlier.
- (7) The money markets abroad have devised a number of short-term instruments for the investors who do not prefer to block up their funds for long periods. The Vaghul Committee's suggestions for the issue of commercial paper by some public limited companies, bills of exchange and such other instruments need serious consideration.
- (8) We can think of even allowing term lending institutions to issue participation certificates with buy-back arrangements, directly to the public so that their resources can be recycled for further development. An active secondary market in such instruments can be developed through the machinery of the Stock Exchanges.
- (9) The R.B.I. should also examine the question of making the general public get interested in the Government securities.

There are other areas related to structure and operations of the Stock Exchanges where new problems may crop up by 1999-2000. Effective steps taken to solve them will in turn, pose challenges.

The total number of transactions in shares may go upto 50 million with a volume of the order of about Rs.75,000 crores for all the Stock Exchanges, in the country, by 1999-2000.

It would humanly be impossible to handle this order of business and conduct the operations of the Stock Exchanges in a smooth and orderly manner if the present primitive and outmoded system of conducting business in the Stock Exchanges continues. There has to be increased competitive efficiency, sophistication and better transparency of operations. Unless the Stock Exchanges are modernised and major restructuring takes place,

through complete automation of their operations with the help of computers with terminal facilities, wherever necessary, installation of terminals or micro-processors for the stock brokers, and resort to other electronic or mechanical aids, the whole administrative system will collapse under sheer mass of documents, paper work and massive build-up of records. There is no escape from such a fresh approach. If this has to be done, the Stock Exchange authorities will have to plan backward right now onwards, in consultation with the management and computer experts, to decide how they should go about the job so that within the next five years, the system becomes operational and gets stabilised thereafter. Simultaneously, the Stock Exchange offices will have to be equipped with adequate telephone and telex facilities, own courier services, etc. Thus, in short, considerable infrastructure facilities will have to be created and the entire stock-broking business will have to undergo revolutionary changes and become highly professionalised to improve upon the present level of operational efficiency and to render better service to the investing public.

Moreover, the number of investors in the country would be between 15 million to 20 million by 1999-2000. Even if we assume that only 10 million investors will use the services of the stock brokers and the rest, those of the sub-brokers, licenced dealers, etc., we shall require a minimum of 10,000 stock brokers all over the country with adequate staff, proper infrastructure facilities and with the capabilities in terms of professional skills, knowledge and educational background. A wide net-work of sub-brokers, agents and licenced dealers will also have to be created. In Bombay alone, we may require more than 2,500 active stock brokers. The sheer compulsion of the emerging scenario will require opening up of all the Stock Exchanges and admission of professionals from outside with minimum ease and with reasonable admission fees not exceeding Rs.5 lacs payable in easy instalments, if necessary. Any restrictions on such entry in any Rules or Memorandum or Articles of Association of the

Stock Exchanges will have to be made null and void by legislation unless the organisational structure of the Stock Exchanges is completely revamped. Necessary powers will have to be vested in the hands of the Governing Boards to decide upon the numbers to be admitted and selection criteria to be decided. Similarly the anachronistic system of dormant membership will have to be done away with, through legislation. There should also be no ban to corporate members or the financial institutions, banks, merchant bankers, to do security business, if circumstances so warrant, as they would have sufficient resources, trained manpower and, other infrastructure facilities which will be required by any one operating in the markets, by 1999-2000. This would lead to a considerable improvement in the services of the Stock brokers to both the individual investors and to the companies whose securities they deal in. The competitive efficiency of the markets would, thus, improve in the process. Small stock brokers with slender resources are not in a position to render prompt and efficient service to the clients, even at present. They will have to merge or amalgamate with others to become viable enough to withstand competition. It appears from the emerging picture that there will be no dearth of business, even without resorting to speculative business, for those who will be properly equipped and are prepared to render prompt and efficient service.

The Stock Exchanges must become national institutions with national outlook and investors in any region should get the best service from any one in the country. We have a lot of lessons to learn from the recent developments in the foreign markets referred to earlier, so far as such aspects of functioning of the Exchanges are concerned.

To move a step further in the direction of the evolution of a national market in our country the restrictions placed by the Stock Exchanges on the opening of offices and on the entry of outside members in their own area of operations will have to be removed except in cases of

small markets that may have been established after 1980 and which may have to be nurtured and where local infrastructure will be required to be created. Even in such markets after a period of 5 years or so, nobody should be barred from doing business. This is necessary to introduce competitive conditions in this business.

A considerable number of new Exchanges will be required to be established or in the alternative branches of established Exchanges or their representative offices will have to be allowed to be opened in different areas in the country, to ensure that the Stock Exchange business does not get unduly concentrated in certain Stock Exchanges and better services are rendered to the investors, in the rest of the country. A number of clearing houses/centres to ensure proper settlements of transactions and prompt payments to investors in certain areas will also be required. Moreover, the entire system of trading and related procedures and practices will have to be streamlined and made uniform for all the Stock Exchanges in the country. Only after we do this, within a stipulated time-limit, electronic linkages of the Stock Exchanges, apart from simultaneously display of prices, can make a real contribution to the evolution of a national market. The comprehensive legislation proposed to be brought forward by the Government should, among other things, take these aspects of the functioning of the Stock Exchanges into consideration.

The burden of healthy functioning of the Stock Exchanges which has to be ensured for meeting the challenges of the future, does not only rest with the Stock Exchange authorities and the stock brokers but also with the public limited companies and the investing public. They cannot be passive onlookers in the transformation which may take place in the Exchanges but will have to extend full cooperation to them. It has to be understood that one of the dimensions of the healthy functioning of the Stock Exchanges is also the performances of the companies listed on the Stock Exchanges. The managements of the companies which have not performed well will have to realise their

responsibilities and obligations and ensure that they remove management deficiencies and improve efficiency of their operations, despite environmental constraints, if any, to come up to the expectations of the investors and to perform better on the Stock Exchanges. All the companies should also streamline the operations in their share and secretarial departments and revise their procedures to ensure that the issues and transfers of shares, payments of dividends, handling of correspondence, etc. are expedited and prompt and efficient services are rendered to their shareholders who are also owners of their companies. Specific responsibilities should be assigned to a designated official of the company who may be asked to submit regular reports to the Board on the working of the share department of the company. Nominee Directors of the institutions should ensure that such reports are submitted to the Boards of the Companies. Listing agreements of the Stock Exchanges with the companies should also provide compliance with such a requirement.

The companies should equally be prompt in being more open and inform the Stock Exchanges about the trends in their working, important developments that affect the same, etc. They should also evolve a code of conduct for all those occupying high position in their companies to ensure that they do not indulge in unethical practice of insider trading and bind them to disclose their operations in the shares of their own companies either on a forward or on a cash basis. The professional bodies like Institute of Company Secretaries, Associations and Chambers of Commerce and Industry, can play an useful role in creating better awareness about the responsibilities of the corporate sector in such matters.

Similarly, the investing public must help the stock brokers by making prompt payments, by properly executing transfer deeds and giving prompt deliveries in marketable lots of shares and by returning the moneys wrongly paid or shares wrongly delivered to them. Stock broking

community also faces a number of difficulties in complying with the requirements of certain provisions of the Companies Act, 1956 and the Registrar of Companies should pay serious attention to the representations and grievances of the Stock Exchange authorities and the stock brokers and redress them where satisfied, or even recommend appropriate changes in the law for the purpose, so that the smooth and orderly trading takes place in the markets.

This sort of cooperation from everyone concerned is required in the national interest to enable the Stock Exchanges to face the enormous challenges at the dawn of the 21st century. They must also share a part of the blame if the Stock Exchanges fail the nation, for no fault of theirs.

One of the most challenging tasks for the Stock Exchanges would be to bring about qualitative improvements in the standards of service, behaviour and conduct of the existing Stock brokers. In the competitive environment that will prevail in future, this is highly important as a good number of highly educated and professionally qualified individuals with refined behaviour, better knowledge, grasp and skills will enter the stock-broking profession and existing stock brokers will have to compete with them on equal terms, for business.

There is yet another dimension to the problem. No elaborate or comprehensive piece of legislative enactment or strengthening of the regulatory machinery of the Stock Exchanges may succeed in its objectives unless it evokes maximum positive response and compliance from the stock-brokers. This can be achieved only if they are given proper training, their perspective is broadened, they are made conscious of their social obligations, their ethical standards are improved upon and they willingly observe the discipline of the Stock Exchanges. Ignorance, in a broader sense, is as much responsible for environmental pollution as financial weakness is for corruption.



In view of the vast potential for business that looms large on the horizon, it is not necessary for them to resort to dubious practices to make money. Recently, the Chairman of U.S. Securities and Exchange Commission said " I believe ethics pays; that there are enormous benefits that come from quality, integrity and ethical conduct ..... good ethics and good business standards are rewarded in the market place."

In the unfolding environment, what an investor would expect normally from the stock brokers is not monastic or pristine purity but more professional outlook, better standards of service, observance of business ethics, necessary skills and better knowledge about their business and the world around them.

Hence, the Stock Exchanges have to organise at the earliest induction courses and provide proper training and coaching facilities for the stock brokers on a continuous basis in consultation with management institutions in the country, so that their technical skills, knowledge and behaviour standards are upgraded; their mental horizon is broadened; their commitment and involvement "in upholding the healthy traditions, behaviour and integrity of the Stock Exchanges" are cultivated; and, the Stock Exchange authorities get maximum support from them in whatever they do for the successful functioning of the Stock Exchanges.

The contemplated modernisation of the Stock Exchanges through automation of their business, complete structural overhauling and provision for infrastructure facilities for themselves and for the existing and additional stock brokers would involve huge financial outlay. Even if the Stock Exchanges persuade their own members to contribute their maximum, in their own interest, their resources may prove inadequate for their needs. The Government should, therefore, consider

helping them financially to meet the shortfall. At the same time the Stock Exchange authorities and their members must commit themselves to implement faithfully all the measures of reform that the government contemplates and carryout their directives issued from time to time, within a stipulated time-frame, without unnecessarily confronting them even in small matters now and then.

I, for one, am not prepared to believe that the Stock Exchange authorities and the stock brokers are in a hurry to write the epitaph of their own organisations. I, therefore, hope that wiser counsels will prevail and trust that the Stock Exchange authorities and the stock broking community will, in their own interest, and in the interests of the investors and the economy extend their wholehearted cooperation to the Government in their sincere efforts to put the business on sound and healthy lines. This will win them a well-deserved accolade from the investors and enable them to make their maximum contribution to the socio-economic development of the country.