INDIAN CAPITAL MARKET —PAST, PRESENT & FUTURE

H. T. PAREKH

1975

Published by

THE A. D. SHROFF MEMORIAL TRUST
235 Dr. D. N. ROAD,
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(i) Publication of one or more books in English, Hindi, and regional languages annually on some of the great builders of Indian economy aimed primarily at educating the younger generation in high standards of building the national economy as practised by those great entrepreneurs and placing the example of their lives for emulation by India's youth.

(ii) Organising one or more memorial lectures annually on subjects which were of interest to the late Mr. A. D. Shroff, namely, banking, insurance, and industrial finance, the subjects to be chosen in rotation, and the lectures to be delivered by persons eminent in these fields.

(iii) Awarding annual scholarship or scholarships to outstanding student or students in the field of management.

(iv) Instituting a prize to be known as The A. D. Shroff Memorial Prize for the student standing first in Banking at the Sydenham College of Commerce, Bombay.

(v) Doing all such acts, matters and things as are incidental or conducive to the attainment of the above aims or objects or any one or more of them; and

(vi) Without prejudice to the above charitable objects or any of them, the TRUSTEES shall have the power to spend, utilise and apply the net income and profits of the TRUST FUND for the TRUST FUND for the charitable object of education or such other objects of general public utility not involving the carrying on of any activity for profit as the Trustees may think proper, it being the intention of the SETTLOR that the income and/or corpus of the Trust Fund shall be utilised for all or any of the aforesaid charitable objects without any distinction as to caste, creed, or religion.

INTRODUCTION

The annual public lectures under the auspices of The A. D. Shroff Memorial Trust have been well received by the public for their informative contents and constructive suggestions.

The Trust was fortunate in having Mr. H. T. Parekh, Chairman of The Industrial Credit and Investment Corporation of India Limited and an eminent authority on Capital markets, to deliver, in the high tradition of the seven previous speakers, the lecture of the Trust for the year 1975 on "INDIAN CAPITAL MARKET—PAST, PRESENT & FUTURE". Mr. Parekh's thoughts on India's economic development not only deserve the serious consideration and response of the powers that be, but are best suited to serve as the blue-print for our economic advance.

The Board of Trustees have pleasure in publishing the text of this important lecture for study and record.

Bombay
10th June 1975

N. A. Palkhivala
Chairman

A. D. SHROFF

(1899 - 1965)

A. D. Shroff's achievements in the field of business, industry and finance were many and varied. A large number of enterprises owe their origin and development to him. As an economist, his predictions have proved right over the years. Through the Forum of Free Enterprise, which he founded in 1956, as a non-political, educative organisation, he sought to educate the public on economic affairs. It was his firm conviction that a well-informed citizenry is the foundation of an enduring democracy.

George Woods, former President of the World Bank, paid, the following tributes to A. D. Shroff :

"In every age and in every society men must express anew their faith in the infinite possibilities of the human individual when he has freedom to develop his creative talents. For this is in large part how the message of freedom is passed from generation to generation. A. D. Shroff spoke eloquently in a great tradition, and thanks to him we can be sure that other great men of India will continue to speak this message in the unknown context of our future problems."

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INDIAN CAPITAL MARKET
PAST, PRESENT AND FUTURE

By H. T. PAREKH

I

For me, it is God's grace to be asked to deliver a public lecture in memory of A. D. Shroff, for a personal reason, apart from whatever other reasons there may have been. In my young formative student days, the name of A. D. Shroff got somehow impressed on my subconscious mind, though I knew very little about him. His background of economics, finance and investment, made a special appeal on me and perhaps, that drew me to these fields for study and career. In this sense, I regard A. D. Shroff as my Guru, and, to be able to pay obeisance to the Guru is indeed the traditional privilege of an Indian disciple. Then came my association with ICICI. Though I never came to know A. D. Shroff very closely, my selection in ICICI and subsequent promotion as General Manager, were both due in great measure to his powerful support. For me, therefore, this is also an opportunity to pay my personal homage to the memory of a great man.

I doubt if ICICI itself could have seen the light of the day but for Shroff. He was the moving spirit behind it. He coined its name, arranged the initial capital for it and gave the services of one of his dedicated senior lieutenants as its first Indian executive, R. C. Doodhmal. We, in ICICI, have come to regard him as its founding father.

Mr. H. T. Parekh, the chairman of the Industrial Credit and Investment Corporation of India, is an authority on the capital market. He is author of several books on the subject.

A. D. Shroff began to be recognised as a business economist from the twenties. He became an authority in the world of finance and industry. He rendered signal service to the corporate sector and to the capital market. His forthrightness and his strong convictions distinguished him from other businessmen and economists. He will be remembered as a crusader of causes in which he deeply believed, especially that of free enterprise. That we are able to cherish his memory through an institution such as the 'Forum of Free Enterprise', which has become a significant instrument of public education in the country, is itself a matter of no small gratification.

II

Let me first clarify myself about the title of this address. By the past, I mean the period up to 1947, when India obtained its Independence. By the present, I mean the period from Independence to the present, that is, the quarter of a century since Independence. By the future, I mean the next quarter of a century.

This division is not as arbitrary as it may at first sight seem. Firstly, the capital market is a living organism and one cannot talk of divisions in it as at a point of time; hence I have taken the period 1947-1974 as representing the present. Secondly, the capital market underwent a qualitative change after India attained independence; it is necessary, therefore, that the break is placed at the point of independence. Thirdly, again the capital market being a growing organism, one has to talk of a period extending over the future. I have taken a quarter of a century as the future of which I would like to speak about. I am conscious that in doing so, I am sticking my neck far out. But, I guess, like all economists, pseudo-economists and

business economists, I cannot help wanting to forecast—even when the forecasts go as wrong as they do with economists.

By the capital market, I mean the market for all the financial instruments, short-term and long-term as also commercial, industrial and government paper. In the past, namely, before the industrial revolution, this paper was confined essentially to commercial paper and was very often related to shipment of goods, though accommodation paper was also not unknown at the time. One might have expected that at least Governments in olden times would have borrowed longer. However, profligate or warring princes found it far easier to finance their expenditure either by borrowing from Jewish bankers as in Europe or from **nagarseths** as in India or by debasing the currency (namely, by reducing the metal content of their coinage).

Long-term paper, or securities as has come to be known in modern times, is a fairly recent phenomenon, and can be most closely dated with the industrial revolution. Significantly, while Government paper today, in sheer bulk, is a very large element in the capital market, the place where security transactions take place is known as the stock exchange or the bourse; this is a misnomer to the extent that government securities are also actively traded in, in the same place, as in the continental and the U.K. capital markets.

Significantly, in India, local people were used to financial instruments from ancient times and comprehended fully the implications of such instruments. **Hundies** and bills of acceptance were fairly well-known in India. Moreover, **nagarseths** almost acted as banks, accepting deposits of money at interest from outsiders. This reflects another aspect which is an essential element in the health of a capital market: namely, the confidence people

have in parting with their money and the confidence which a deposit-accepting authority induces in the depositor by his standard of integrity. As I said, in both these respects (in understanding the implications of paper and in the integrity of the **sahukars**), Indian people were reasonably conversant with the elements of a finance market.

III

Therefore, when the first modern factories came to be put up in India and companies were allowed to issue paper with limited liability on the market, Indians found it fairly easy to adjust to the new era of stocks and shares which are essentially permanent instruments on the market. I shall give two examples of how easily the Indian community adjusted to the new era of industrial financing. Firstly, not only were shares and stocks, even when privately floated and actively traded in privately, but that essential element of financial genius—namely, manipulation of share prices—was also witnessed at a particularly early stage after the floatation of companies; in fact, charges of financial manipulation began to be made against some entrepreneurs in the 60's of the last century.

Secondly, as I mentioned, shares were traded in privately at an early stage. By 1870, sharebrokers had found a place, I believe under a tree, to meet at fixed hours and, beside exchanging gossip, to trade in shares. Very few people must be knowing it, but this year marks the centenary of the formal opening of the Bombay Stock Exchange as a body, and you will note that the actual name of the exchange was for long 'The Native Share and Stock Brokers' Association'; this clearly indicates the indigenous character of this stock exchange. Only recently, the name has been changed to the 'Bombay Stock Exchange'. Not many people would be aware today that in the second half of the last

century, several joint stock companies were floated to develop and reclaim land near the sea in Bombay and through these floatations as of banks, public learned to trade and speculate in shares, often at much loss to themselves because there were heavy fluctuations in their prices.

This ability to understand financial instruments is not an ability commonly found everywhere. In fact, the Bombay Stock Exchange was the first to be opened in Asia; the stock exchange in Japan opened much later. Moreover, stock exchanges in many countries like Iran, Malaysia and so on, began operations only during the last 15-20 years and in Iran, even now, it is in a rather early stage of development. Thailand and Indonesia hardly have stock exchanges even today.

There is one other characteristic of the Indian capital market in the early times which I would like to refer to, namely, the fact that in the first stage the stock exchange was really only a stock exchange dealing in shares. The British Government of India had still not found the courage to place paper on the Indian market, and used to borrow, on India's behalf, on the London Market. This hesitation about Indian enthusiasm for a colonial power's loan issues, might have deterred the then Government of India from raising money on the Indian capital market. This was partly because the other requirement for the success of a capital market, namely, banks and other financial intermediaries, had still not appeared in a large enough volume on the Indian capital market. The stock exchanges were dependent not upon institutional investors, but essentially upon individual investors for their operations.

Having described the characteristics of the first beginning of the modern capital market in India,

I shall briefly cover the growth of the capital market from the period 1860-1947. In the first place, in western India, the stocks mainly traded in the present century were those of cotton textile mills. The floating stock of shares was limited and most mills were identified with individual entrepreneurs who held a considerable part of the capital. In Ahmedabad, in keeping with the traditions of that city, deposits made their first appearance as sources of finance for setting up textile industry with a relatively small capital base. Though the stock exchange existed, trading was thin as major part of the capital remained with families. In eastern India, industry was mostly British-controlled (or rather Scottish-controlled), the capital in early days were issued in the U.K. and was designated in £ sterling (vestiges of which we see remaining even today, e.g., Calcutta Electric), though Indian investors did not hesitate to deal in such securities within the country (and in the case of a company like Indian Copper before its nationalisation, almost all shares, though denominated in sterling, were held within India). The shares in the eastern sector comprised mostly jute, coal and tea shares, and increasingly in the present century, rupee companies were floated and they came to dominate the stock market. Compared to Bombay, a large number of companies were listed on the Calcutta Stock Exchange. In Madras also the Stock Exchange existed, but it could not make any significant impact. Over the years, the centre of financial gravity shifted more and more to Bombay and due to a complex of factors, Calcutta as the capital market lost some of its importance, though it continues to be the industrial capital of India.

Government might have been aloof from the capital market in those days, but the volume of securities offered on the Indian capital market increased and the industries which were covered by

these securities, became more diversified. In 1920, hydro-electric shares were offered by Tatas on the Indian market and later in the thirties, paper, cement, sugar and other industries came on the market.

Perhaps, the key point in this period was the year 1911. Jamsetji Tata, after his long search for a suitable location based on sources of iron and coal deposits, had landed at Jamshedpur (or Sakchi as it was then called) as the site for his first steel plant. The capital structure of the proposed company was complicated (particularly by the issue of deferred exchanges for about 40 years upto the time they were compulsorily converted into ordinary shares). However, when Jamshetji tried to raise the money for the venture in the London money market, he met with a negative response, partly based on the lack of confidence in the viability of an iron and steel industry in this country and partly because Jamsetji had decided to depend only on a foreign consultant called Perrin (technical or financial collaboration, which is the rage among our modern entrepreneurs, was not known then). Frustrated, the Tatas decided to try their luck on the Indian market, and unbelievable as it may seem, the Indian investors had such a risk-bearing or speculative instinct and had such confidence in the name of the house of Tatas that they queued up to buy the shares, and the shares issue was an overnight success. With this issue, it can be said that the capital market, as an institution, had established itself in India.

The first world war, with its rising expenses for the Government and with increasing liquidity with the local public, gave some confidence to Government of India to float increasingly Government securities on the Indian capital market, though Government of India bonds first in sterling and then in Rupees were current since a long

time. By 1917, an industrial commission had been appointed, which recommended certain incentives being given to industrial units set up within India; it even suggested an examination of the possibility of setting up an investment bank to provide capital to such units.

While I have discussed the evolution of the Indian capital market in fairly glowing terms, it has to be recognised that it was a limited market in various senses. Firstly, the investment habit, as is natural, was confined to the literate upper class urban people. Secondly, not everybody was a Tata and new entrepreneurs had first to establish themselves and their names through their own capital or by raising capital from a selected group of friends before they could approach the market for finance. Actually, the continuing recession of the twenties resulted in heavy losses to the investor who had invested in textile and other shares. Thirdly, financial institutions, like banks and insurance companies—particularly those with Indian ownership—had still to be established in India, and, therefore, institutions were still not an inherent element in the Indian capital market.

Many points were examined in great detail in the very competent and thorough reports of the central and provincial banking inquiry committees set up in 1931. The reports referred to the difficulty of new entrepreneurs in getting funds on the market and suggested setting up of an investment corporation to provide finance to them. The examination of the issues in forming such an institution showed the depth of thought of the committee members, the institution suggested by them being very nearly like the modern development finance companies. The fact that the Industrial Finance Corporation of India could be set up through statutory legislation within less than a year after India's independence, shows the considerable ground work

which the enquiry committees had done to enable such a quick establishment of the Corporation.

Till the start of the Second War, investors invested not only in shares of Indian companies and of Sterling companies operating in India, but also in shares of foreign companies quoted in Singapore, Colombo, London and New York. Many Indians held these shares as investment; in addition, some of the shares of foreign companies were "offered" by brokers and were speculatively traded in. This era of freedom of investment ended with the imposition of foreign exchange control after the start of the Second War.

By early forties, stock exchanges had proliferated and all metropolitan towns had one stock exchange; so also the number of securities traded in. I shall deal, in brief, with the events between 1939 and 1947. These years saw a great growth in the floatation of government securities on the local market. Secondly, since very few industrial units could be established during the period (owing to lack of import of capital goods), there was a dearth of industrial securities on the capital market. However, with war-time inflation and rapidly increasing money supply, there was a boom in the floatation of new banks and insurance companies. This situation apparently benefitted the shares of existing companies which not only were making fancy profits in the war time inflationary period, but had not to face much competition from new capital issues. As I mentioned earlier, Tata Deferred became the king of the capital market; fluctuation in this share has never been equalled by anything in the past and will never be equalled by anything in the future.

Between 1937 and 1947, the stock market went through violent ups and downs, moving with the changing fortunes of the world war. Speculation

and gambling reached its high water mark in these years. 1936-37, 1939-40 and 1943-46, were boom years in the stock market followed by slump. They saw hectic activity in the new issues market. The wild and sweeping frenzy witnessed in the capital market in 1943-46 was phenomenal. I cannot recall any other period before or since which could be comparable to it.

Thirties and forties were years of low interest rate. The economic revival of the peace time and the subsequent war time developments were based on a stable policy of moderate interest rate structure, both short-term and long-term.

IV

The period since 1947, as I mentioned earlier, marks a qualitative change in the Indian capital market over the earlier period. Two main characteristics which indicate this qualitative change I mention immediately; firstly, the greater institutionalisation of the finance function during the period; and secondly, the predominance of Government control over organised finance which has come about by now. Both these characteristics I shall deal with in greater detail later.

The period opened with the commencement of operations by IFCI in 1948. This was the beginning of the institutionalisation process, which led to the opening of the SFCs during 1952-53, of ICICI in 1955 and of UTI and IDBI in 1964. Last year, the financial institutions taken together sanctioned about Rs. 500 crores of financial assistance, the assistance rising at the annual rate of about 20%. It is estimated that 30% of the private sector investment is the result of capital provided by the institutions.

This development enabled entrepreneurs to obtain finance, both underwriting and loans, in a

fairly easy way, provided they met with institutional requirements regarding the viability of their projects. To an extent, it relieved entrepreneurs of the worries of having to raise funds. It has to be said to the credit of financial institutions that they have been willing to provide funds to industry in the worst of times on the capital market, when investors' interest in investment or business confidence due to recession has been lowest. Financial institutions are an integral part of the capital market, and they have served to broaden it. At the same time, they have acted as substitute for the capital market particularly during periods of stock market recession, especially in regard to new issues of industrial securities.

But, I am not sure whether this has been a wholly desirable development. In the early days, entrepreneurs like Kirloskar, Seshasayee, etc., had to go from house to house to obtain their finance, and, in a sense, felt a personal obligation to make their units a success and to honour their commitments to their financiers. I am afraid industrialists have found too easy an access to finance through the financial institutions, and while paper project reports are made to convince finance institutions of the viability of the projects, industrialists have not always felt the same obligation to honour their commitments as the entrepreneurs in the earlier, harder days, had felt. In any case, institutional finance has been a blessing to industry as a whole.

One other important development during this period was the entry of Government on a large scale into industry. Financing of public sector projects has till recently been done by Government, thus leading to larger issues of Government loans on the capital market, and no public issue of share or debenture capital by the public sector units.

This system of financing has undergone a change, particularly during the last 3 or 4 years. Government has come to recognise that the discipline induced by banks and finance institutions in industry and the answerability of industrial units to investors are essential elements in the success of an industry. Hence, in more recent times, Government has encouraged public sector units not only to approach banks for their working capital and the finance institutions for long-term finance, but to approach the public for subscription to share issues. This is a trend which I wholly welcome as not only being in the interest of the public sector units in keeping them on their toes as regards their performance but also in the interest of Government by relieving it of the obligation of providing all the finance needed by public sector units, out of budgetary resources. For the entrepreneur, equity capital has the merit over loan financing of no obligation to repay, but the investor naturally expects a better return on his investment. Neither the industrialists nor the Government have yet come to recognise adequately the role of permanent basic equity capital and the continuing need to strengthen the capital structure of a company whenever there are opportunities to do so.

The flow of the Central and State Government Securities into the Indian capital market increased manifold during the quarter century after 1947. Including securities floated by autonomous government corporations, the annual issues would soon be nearing Rs. 1,000 crores. However, this has remained mainly a sheltered market, subscribers to government loans being mainly institutions which are required under law to hold a part or all of their funds in Government securities, e.g. banks, insurance companies, employees provident funds, etc. There has, thus, been a large increase in Central and State Government outstanding loans over

the last quarter century, the amount of outstanding marketable loans being Rs. 7,500 crores as against Rs. 2,000 crores in 1951.

The process of Government acquiring ownership or control of institutional funds began with the nationalisation of life insurance in 1955. Thereafter, the great measure taken was to nationalise large Indian banks in 1969. With the nationalisation of the Reserve Bank in 1949 and with the start of statutory finance corporations like IFCI, SFCs, IDBI and UTI, Government has also a predominant share in the central banking authority, in the long-term finance institutions and in the investment of private savings. Today, perhaps, 90 per cent of the investment of organised savings is either owned or controlled, directly or indirectly, by Government. It thus marks a remarkable change in the composition of the Indian capital market whose implications we have still to gauge fully.

It is in this context that one has to analyse the trends in the Indian capital market during the last 25 years. As I mentioned earlier, the market for Government securities is narrow and essentially sheltered, though a wide variety of securities has now come into being such as bonds of electricity boards, land mortgage banks, state finance corporations, etc. The volume of Government securities now available on the Indian market is very large and the number of investing agencies is continuously in the market looking for these securities for investment and for switches. They do lend a good deal of support to the stock exchange activities.

Secondly, the major upsurge in the Indian capital market has been brought about by the process of industrialisation in the country triggered off by planning. By 1959, partly as a result of the institutional structure already built up and partly as a result of the great boom in the Indian economy

(following the foreign exchange crisis of 1957-1958) and growing investor confidence in securities, the country saw a vast upsurge in new capital issues in a diverse group of industries. The investment fever took such a hold of even ordinary people, that issues of entirely new companies, sometimes floated by entrepreneurs without any industrial experience, were oversubscribed anything between 20 and 100 times. Fortunately, most of these companies came out reasonably well during the next decade, though investors have been left with some babies in the form of shares in new companies which have not made good. After a relapse in the sixties, there was an interesting revival of the stock market and of the new issues market in the early years of the present decade, though after that the market got a rude shock in the second half of 1974.

No longer does the Indian capital market comprise shares of a few companies belonging to large houses and confined mainly to established industries like cotton and jute textiles, sugar and cement. The Indian capital market now comprises shares in diverse group of industries including engineering and chemicals, fertilisers and petro-chemicals, automobiles and ball bearings and so on, (shares of some groups of industries such as coal, banking, insurance, have on the other hand disappeared from the market on account of nationalisation). Moreover, some of these issues were floated by entrepreneurs who were not even heard of in the pre-war period. Their assets have risen over the Rs. 20 crore limit, attracting the provision of the MRTP Act. Part of the credit of this goes to finance institutions who have provided the initial underwriting facilities and taken the risk involved in investment. However, I would like here to pay my tribute to our entrepreneurial class and say that a major factor in the broadening of the Indian capital

market has been the good performance of the companies set up by them, reflecting their entrepreneurial and managerial abilities.

Thirdly, the start of the UTI in 1964 added a new dimension to the capital market. It enabled the savings of small investors to be invested in industrial securities. Despite initial doubts about its success, UTI collected, in the first 10 years of its existence, about Rs. 200 crores. Investment of these funds in shares and debentures constituted the principal support to the stock market in the last decade. UTI has been lucky in its top executives: when initially confidence had to be built up in small savers, it had as Chairman, Shri R. S. Bhatt, who followed a somewhat cautious investment policy. Once confidence was built up, Shri J. S. Raj, its present Chairman, gave it the necessary dynamism by accelerating investment in ordinary shares.

Fourthly, the market for industrial securities has become broader. It is my guess that there must be over one million shareholders in this country. The number of investors, though apparently small, is really large considering the illiteracy and the average low *per capita* income of the Indian people. Investment has been broadened in the sense that a large number of investors who now hold shares are from mofussil areas. Institutional investment agencies have also multiplied, though due to nationalisation of life insurance, investment decisions of those funds have been centralised. A large number of financial institutions who initially invest, come in due course as suppliers of industrial securities to the market. This helped the process of broadening the stock exchange activities.

Operations on Indian stock exchange were not pristine pure, though, under very able Chairmen, Bombay Stock Exchange maintained a high standard of discipline in its operations. As stock ex-

changes proliferated, the scope for manipulations increased. The stock exchanges were brought under some regulation through the Securities (Control and Regulation) Act, passed in 1956. Deficiencies and malpractices in Corporate Management necessitated regulation of companies through a series of amending acts of company law, initiated in early fifties by Shri J. J. Kapadia, that great champion and protector of the investor.

Finally, the activity on the stock exchanges has been determined directly by various factors. The more important of these are : (a) the floatation of new companies, which is determined mostly by Government licensing policy; (b) entrepreneurial zeal, which is determined by incentives given by Government; and (c) investors' confidence, which is determined by Government pronouncements and policy measures and by the performance of industry and incentives to investors.

The shape of the stock market today is altogether different from what it was at the end of the earlier phase in 1947. The system of forward trading has been eliminated. Investment activity now dominates the market. Brokers have even gone one step further and begun to take on underwriting risks in the new issue market. Investment banking, merchant banking, porfolio management, arranging finance for industry by securing deposits and other means, now characterise the stock market activity. The community of brokers now presents a youthful appearance, wanting to adjust itself to the needs of modern corporate industry.

As with women, so with the market, conditions are often volatile and fickle. This gives an air of romance to the Indian capital market—as also very often an air of disillusionment. This is the position of the capital market between 1947-1974.

During this period, the stock market as well as the new issues market, went through several vicissitudes. The more significant periods of buoyancy were the years 1958-62 and again 1971-1974. Otherwise, in the sixties, the stock market activity remained at a low ebb.

Ironically, however, due to the operation of a variety of factors, the genuine investor has got a raw deal in recent years. While the new investor who made investment in new industries has by and large done well, the pure long-term investor whose primary concern was to get a fair and reasonably steady income and who, therefore, invested the bulk of his savings in blue chips, such as electricity company, steel and cement company shares has been hit the hardest. His income has suffered and also his capital has substantially depreciated. He has even begun to wonder and is even advised to take his loss and liquidate these long-term investments and to put the funds in deposits with companies to earn higher income.

The problem of investment versus lending has today assumed serious importance. The very future of the investment market may be in danger unless industrial policy, monetary policy and fiscal policy are co-ordinated to give special impetus to investment.

During the period 1947-75, one major development which had wide consequences was a shift in official policy from one of moderate interest rates to one based on high interest rates. This shift began after 1960. From its inception in 1935 to 1960, that is, for 25 years, a stable policy of moderate interest rate structure was followed by the Reserve Bank of India. Then abstract considerations began to take precedence over historical factors. The thinking that a developing country must necessarily pursue a policy of high interest rates began to gain

ground. This view got strong support from the rapidly developing inflationary situation in India and the outside world. Rapidly rising interest rates, particularly in the short-term market, after 1970, began seriously to affect also the long-term rate structure.

Despite the growth of the Indian economy generally, the sixties and the first half of the seventies, have been marked by stagnation so far as new capital issues are concerned. Annual figures of capital raised have varied between Rs. 50 crores and Rs. 80 crores, between 1963 and 1971. 1962 was the peak year when Rs. 97 crores were raised. After 10 years in 1972, this figure was again touched. In this sense, the Indian capital market has lagged far behind in mobilising new capital for industrial development.

V

Finally, the most hazardous part of the exercise, namely, forecasting the future of the Indian capital market. I am a born optimist and let me begin by saying that I see a bright future for the Indian capital market.

When one considers the future, one has to start from a base of one's own philosophy. Therefore, I consider it necessary to lay down my own ideas of the future on the basis of assumptions which I hold about general developments in the economy.

I consider that the growth rate for industry will have to be accelerated from the present 3% or less to a minimum 10-12%. I must hasten to add that similar growth in agriculture must also be achieved, because these two sectors can only grow together. In fact, this can be achieved only provided building activity, transport and power sectors

are also developed. This is not ambitious, considering our problems and considering that these are rates which are specified under our plans. If the rate of growth of industry is to be 10-12%, we will have to gear the capital market to achieve this growth. That is to say, that, if today it is able to mobilise new savings of about Rs. 100 crores, it must be able to mobilise Rs. 300 to Rs. 500 crores of new capital in less than a decade. It has been my feeling that for long Government has taken a casual view of the capital market, as if it mattered little what happened on the stock exchange and in the new issues market. However, it is essential to make a conscious and determined effort to evolve a policy jointly with financial institutions, banks, stock exchange authorities and the corporate sector with a view to mobilise substantial capital on a continuing basis.

The economy has reached a crucial phase in its development. We have built up a large intangible infrastructure of experience, industrial skills, consultancy organisations and so on. We have built up a large capital goods sector. We have even entered a new phase—of joint ventures in foreign countries. India is able to export both know-how and capital goods for setting up enterprises abroad. However, it has to be realised that the phase of import substitution has gone, and new incentives have to be found if industry is to grow at the rate specified earlier by me.

We need to review the Industrial Policy Resolution itself in the light of the progress we have made in the industrial sector during the last 25 years. Government has reserved under the Resolution some spheres of activity for itself. It is necessary that just as Government has the right to set up enterprises in spheres where private sector has been left free to set up manufacturing facilities, the private sector if necessary,. with Government

participation is allowed to set up enterprises in which Government has at present a monopoly but which the Government has at present no adequate plan to set up. I am saying this because technology, skills of entrepreneurship are more widespread in the country and they need to be mobilised to the country's best advantage. For example, I do not see why helicopters cannot be built by private industry. Monopoly in Government hands may in some cases result in slowing down of technological progress.

Government is modifying its policy in the field of off-shore oil exploration by having joint ventures with foreign firms on suitable terms. This is a welcome shift from our earlier policy because of the vital need to develop our own sources for oil. From present indications, we might well have a break-through in oil exploration—both inland and off-shore. This whole field of finding oil and transporting it to the refineries, is highly capital intensive and for Government to be successful it would have to adopt a policy which would be able to mobilise resources available within the country—of capital, entrepreneurship and skills. I am saying this to illustrate my point that the industrial policy which was framed long back requires a critical re-examination.

To achieve the growth rate suggested earlier, we shall have to lay down clear priorities of action. Today, the first priority would be to utilise the capacity which has been already set up in the country. A second priority would be to expand the capacity of existing units, particularly as such expansion takes place from an established base by units which have experience and resources, and, therefore, the expansion is, in terms of capital cost, relatively cheap. Thirdly, we need to build up a large number of new companies so that we set up new nuclei for expansion of the industrial base.

There is considerable talk that there is a shortage of resources. One has to understand what is meant by this phrase "shortage of resources". Even when there is an over-all shortage of resources, at any point of time there is a certain flexibility in movement of available resources from one use to another. This particular task can be fulfilled by the efficient use of available resources. The more relevant or immediate problem is how best to mobilise the available resources for development.

I am suggesting this because, when under strain, most economies have been able to produce far more from the same resources. For example, during war times, economies have been able to expand their production even when investment has been kept at a low level. We are under the same strain today, and the task of planning should be to ensure that we use the resources to the maximum advantage. I would give an example: if the Wankhede Stadium was completed in such a short time, it was mainly because of the pressure that was brought on the job as a result of a dead-line set for its coming into operation.

If the rate of growth and of investment mentioned earlier by me, is to be achieved, we shall need to give a fairly close look to the procedures which govern the setting up of industries. Time is the most essential factor in developing industrial capacity. In almost all procedural requirements—whether of Government, of financial institutions, banks or of other bodies—time seems to be discounted as a factor in industrial expansion. All these departments and institutions tend to look at the same problem from different angles and in the process, lead to considerable loss of time in setting up capacity. It is necessary to cut the involved procedures and to unify the control mechanism so that time is saved. The time has come when we need to prune over-lapping regulations under multiple

legislation. We need to be freed from the shackles of over-regulation.

Government has also to rethink its ideas on corporate size and monopoly. Companies are becoming large not only because with new technologies the scale of operations is becoming larger, but because of inflation. The concept of Rs. 20 crores as the threshold above which monopoly investigation requires to be done has little relevance today.

What I am suggesting is that ultimately the capital market has to be related to one corporate philosophy. In this area one sees a considerable degree of ambivalence in thinking. We want industries; we want efficient industries; and, therefore, we will need large enterprises. Moreover, given the size of the country, it would not be possible for all this to be done exclusively in the public sector. If so, we have to decide to take advantage not only by mobilising public savings but also to mobilise entrepreneurship. This is the only choice before our planners for some time to come.

Gradually, the scale of projects being set up in the country has increased, even in the private sector. While in the past, projects above a capital cost of Rs. 5 crores were rare, today there are few projects which do not cost more than Rs. 5 crores. This has happened partly because industries (like aluminium, fertilisers, automobiles) which entrepreneurs are now entering into, are essentially large-scale industries requiring huge capital. Moreover, thanks to inflation which is now world-wide, the capital cost requirement for a plant of the same size has increased manifold during the last 10 years. Thus, projects in the private sector have become large. In the Government sector, this was always so.

Financing of such large projects cannot be done by internal accretion or accumulation of

funds. Consequently, the need for such units to approach financial institutions and the capital market will increase over the coming years. Moreover, since the larger projects are usually taken up by entrepreneurs who have some industrial experience, their effective and successful implementation can generally be taken as assured.

The capital market in effect, generates resources, bringing in more resources in buoyant times (as during the period 1958-62 and 1971-73). On the other hand, when industrial conditions are bad—and capital markets essentially reflect these industrial conditions,—there is lack of resources. In other words, the problem is to create sustained conditions of buoyancy which are at present latent.

It is necessary, therefore, that we try to improve the conditions of the capital market, and for that purpose, improve the condition of industry. One means of doing so would be to continue the development rebate so as to stimulate both savings by the corporate sector and investment by it. Development rebate has done more to stimulate industry in the last 25 years than perhaps any other single measure. Today, it is even more needed than in the past.

It is also necessary to provide incentive for personal savings. We have at present various ceilings on incentives for savings through provident fund, life insurance and so on. I suggest that these limits be raised at least by 50%. These incentives force people to save and they have a direct impact on the volume of available savings. It is also necessary to stimulate newer types of savings; for example, tax incentives for pension schemes within the limit for compulsory savings which I have suggested. I am conscious that this will lead to some loss of revenue by Government, but then it would be able to mobilise more savings. It will also be

more than made up by increased future investment which would yield to Government revenue through excise duties, corporate taxes and sales taxes.

As regards corporate savings, I suggest that incentives be given on profits which are retained by corporate enterprises. This was the case at one time and this incentive should be restored. At present, the volume of retained earnings in companies annually is Rs. 500 crores. As the corporate sector grows, this figure will continue to increase and we must work towards augmenting the source.

Perhaps, one area which can think of as having considerable scope for joint action, is with the newly rich oil countries. These countries have vast resources and low investment opportunities. It is necessary to recognise that so far India has attracted capital which is tied to the import of know-how and capital goods, as in the case of joint ventures set up by foreign multinationals in India. The capital from the Middle East is of a different character. It is essentially a liquid portfolio capital which is seeking safety and adequate return.

Two things can be done to tap these large resources available with these oil countries : if we are to attract such capital, it is necessary that we review our policies regarding capital imports so as to facilitate import of such capital. On a selective basis, portfolio investment by non-resident Indians and of surplus funds from Arab countries, would flow into India provided the present rigid official policy under the exchange control legislation and foreign regulations are liberalised. The existing regulations are outdated and call for drastic revision. I would urge urgent consideration of this matter for attracting free capital from the neighbouring countries.

At the same time, as I mentioned earlier, the flow of securities on the capital market and the

flow of business to the public finance institutions from public sector projects is likely to be many times larger than the negligible amount which has come to the market and the finance institutions till 1974. This will open up a new source of investment to investors and broaden the basis of the capital market by the issue of securities of diverse industries promoted by Government.

Some new moves by Government in recent times are in the right direction. Gradually, public sector units are being required to go to banks and finance institutions to obtain their required finance. Thus, they are being subjected to financial discipline.

Similarly, it is desirable, as is now happening, that Government allows public sector units to approach the capital market for subscription to equity capital in them. Just as Government has laid down at present that foreign companies as also Indian promoters hold 40% of equity in new enterprises, Government can also adopt the rule that it will hold 40% equity in projects promoted by themselves, retaining an additional proportion through finance institutions, and offering the small balance to the investing public. Government control over management and ownership can thus be ensured and at the same time the public will have a wider choice for employment of its savings. The notion of joint venture can be thus extended to apply also to Government. I see nothing but good if such evolution of joint venture were to take place in our country.

Thirdly, despite the present gloom, I am confident that the portfolio of UTI may reach steadily to Rs. 700 crores by the end of the century. LIC's funds (in 1964 Rs. 1,000 crores) now over Rs. 2,500 crores, will grow yearly and will easily go over Rs. 10,000 crores. This will have a sizeable influence

on the capital market even when this market, as I said earlier, itself will have grown manifold in the number and value of securities traded in. This institutionalisation of individual savings will be a source of strength to the market.

Fourthly, the average Indian is becoming more literate and even slightly richer. If the development process and planning succeed, and if we are able to overcome the present stagnation into which the economy has fallen during the last three years, this process is likely to be accelerated over the coming years. If so, the availability of funds in the Indian capital market and the ability of investors to invest in the riskier forms of finance like shares, will increase over the coming years.

There was considerable distrust of conversion of loans into shares when it was first introduced. However, it will be noticed that in recent times, entrepreneurs themselves have seen the advantage of using convertible bonds to raise funds on the market. Thus, the market mechanism has changed and so also the market instruments.

In this connection, I wonder whether the recent restrictions on companies accepting deposits would serve Government's purpose. Companies are trying to seek deposits directly, and as more and more companies come to do so, the volume of company deposits will grow, even when the proportion of their owned-capital which companies are allowed to raise as deposits is reduced. The reasons why companies have resorted to such deposits are mainly two : firstly, dividend restriction has dried up the market for capital and made deposits with companies more attractive; secondly, bank interest rates for lending have become so high that company deposits have become a cheaper form of borrowing. If bank lending rates are lowered, if restriction of dividend payment is removed, and

if some tax incentives are offered to investors, savings will again begin to flow into long-term investment where prospects of capital appreciation are great and they will move away from deposits. Capital market is today distorted. When these distortions are removed, a balance will be restored for savings to flow into investment channel.

Finally, the present interest rate structure in India has almost led to the fact that very little non-institutional, non-captive subscription into Government loans takes place. This is partly because the returns to be earned on subscription to industrial debentures and preference shares is high. When the interest rate structure becomes more aligned, preferably by the reduction in the rates of interest on bank loans, there is likely to arise an integration between the market for Government securities and the market for industrial paper. Official efforts in this direction have begun, and will continue, to bring about the required integration.

We shall need to re-think our policy on interest rates, particularly if the present inflationary tendency is checked. The present high rates of interest to some extent reflect an attempt to control inflation. Once inflation is controlled, it would be desirable to lower the interest rate structure. The present trend all over the world is to lower interest rates, as one means to stimulate growth. In our country, I would favour a reduction in the Bank Rate, as a means to stimulate the economy. It will give a psychological boost to investment. This will itself help to bring about a cohesion and integration in the interest rate structure.

One more reform needed is in respect of the Indian Trust Act. At least in respect of public utilities like electricity companies as also priority industries like steel and cement, it is desirable that the securities issued by companies in these indus-

tries be declared trustee securities. They yield attractive, steady return. If only 10% of the new provident fund and other trust monies is permitted to be invested in units of the UTI and in blue chips, not only will the investment be stimulated but a better synthesis in the interest rate pattern for long-term capital would emerge.

Government has taken the first step by amending the Indian Trust Act, 1882. It could review the present situation in the capital market to formulate a revised policy both to broaden the capital market and to establish a better harmony in the interest rate structure.

Summing up, a historical review shows that the capital market in India has grown on its own impetus. The changes brought about in it since independence have strengthened it. The potential of the Indian capital market is immense. It can help a great deal in establishing people's socialism in India as opposed to centralised or bureaucratic socialism by tapping public savings, engendering a sense of public participation as also management accountability to public. In South Asia, it is the only capital market which is capable of growing into an international centre. It has an inherent strength which very few markets possess. Both Singapore and Hong Kong are highly developed but they do not possess inherent strength. With the centre of financial gravity shifting to the Middle East, India is sure to command increasing interest. But, this can happen only if we are able to re-design our complex structure of regulations affecting flow of capital. This would call for a new vision and a new strategy. We would have to emerge out of the maze we have built for ourselves. A new order is emerging. We need to open up our closed economy on a selective basis. We have to cast our sight to a new horizon. Let us hope that we will be able to see the new vision and endeavour to achieve it.