The Future of Stock Exchange

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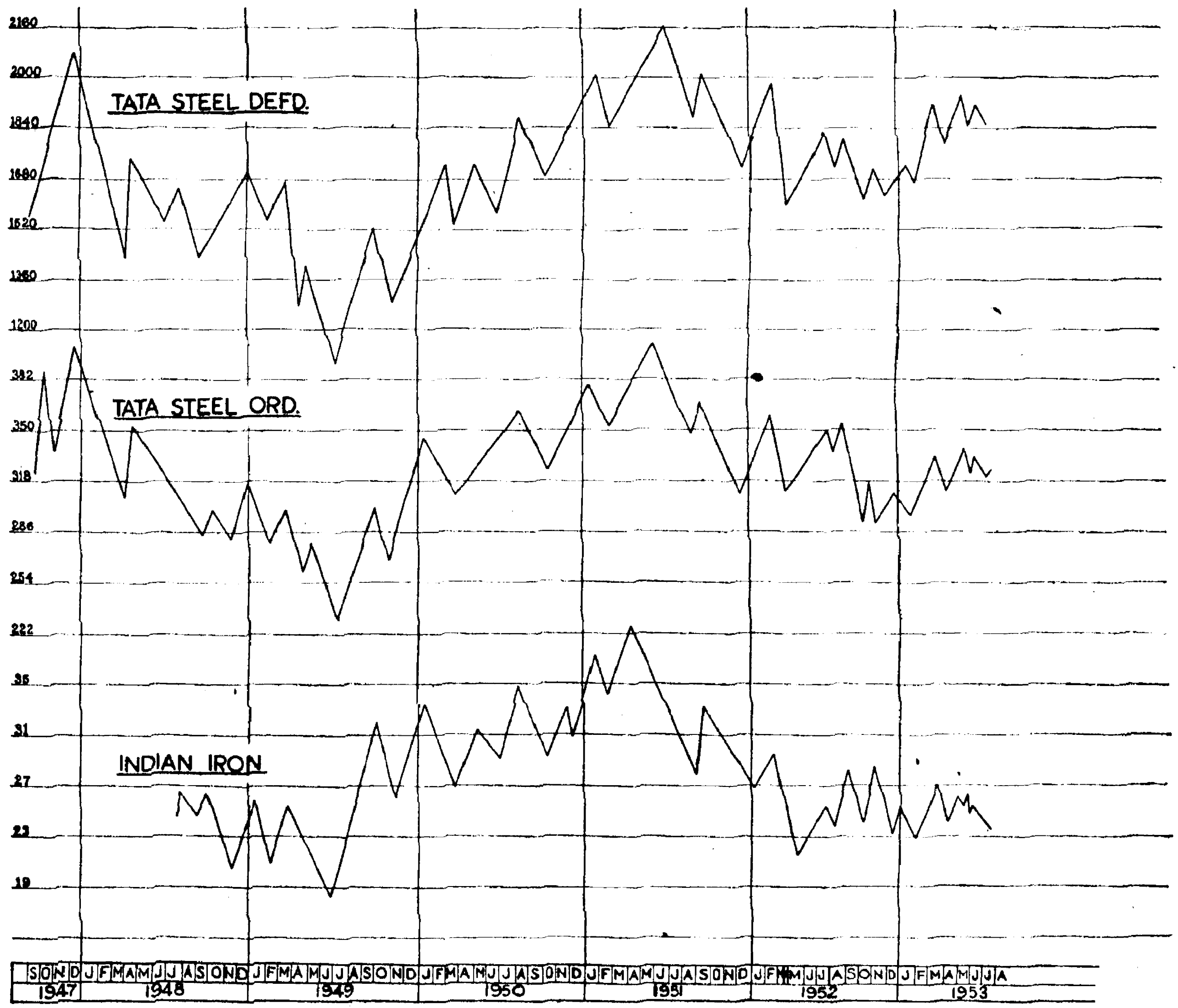
Whether aggregate savings are jailing or not, there is scarcely any doubt about the decline in the size of the average private investment. This means more small savings in a form which brings no business to the stock exchange, eg, saving certificates, savings bank deposits. The substantial private investor whose operations constituted the average broker's most remunerative type of business is now a vanishing type.

The concept of Welfare State is not conducive to the attraction of ' risk' capital. There is scarcely any future for the stock exchange as it is organised today.

THE stock exchange has generally been described as the barometer of a country's economic and political weather. It is not interested in the past or even in the present. It is constantly looking ahead. This is because it is the stock market where the best informed minds of business and finance commercialise their knowledge of impending changes in the economy long before such facts become generally known. Manipulation is possible in the day-to-day movement of stock prices, and secondary reactions and rallies are subject to such an influence to a more limited degree, but the primary trend can never be manipulated. The stock market is fairly authoritative and instructive. It is risky to ignore its verdict.

The 1946-49 bear market, the biggest in the history of Indian stock exchanges, began as an inevitable reaction to the engineered boom that followed the premature, although deliberate, abolition of the Excess Profits Tax, and the pursuit of artificial cheap money policy. Subsequent political and economic vicissitudes, through which the country had to pass, accentuated the downward drift in equity values. Economic consequences of the partition of the country alone were very serious. Independence treated many new economic and political problems. The downward trend in equity prices reflected falling out-



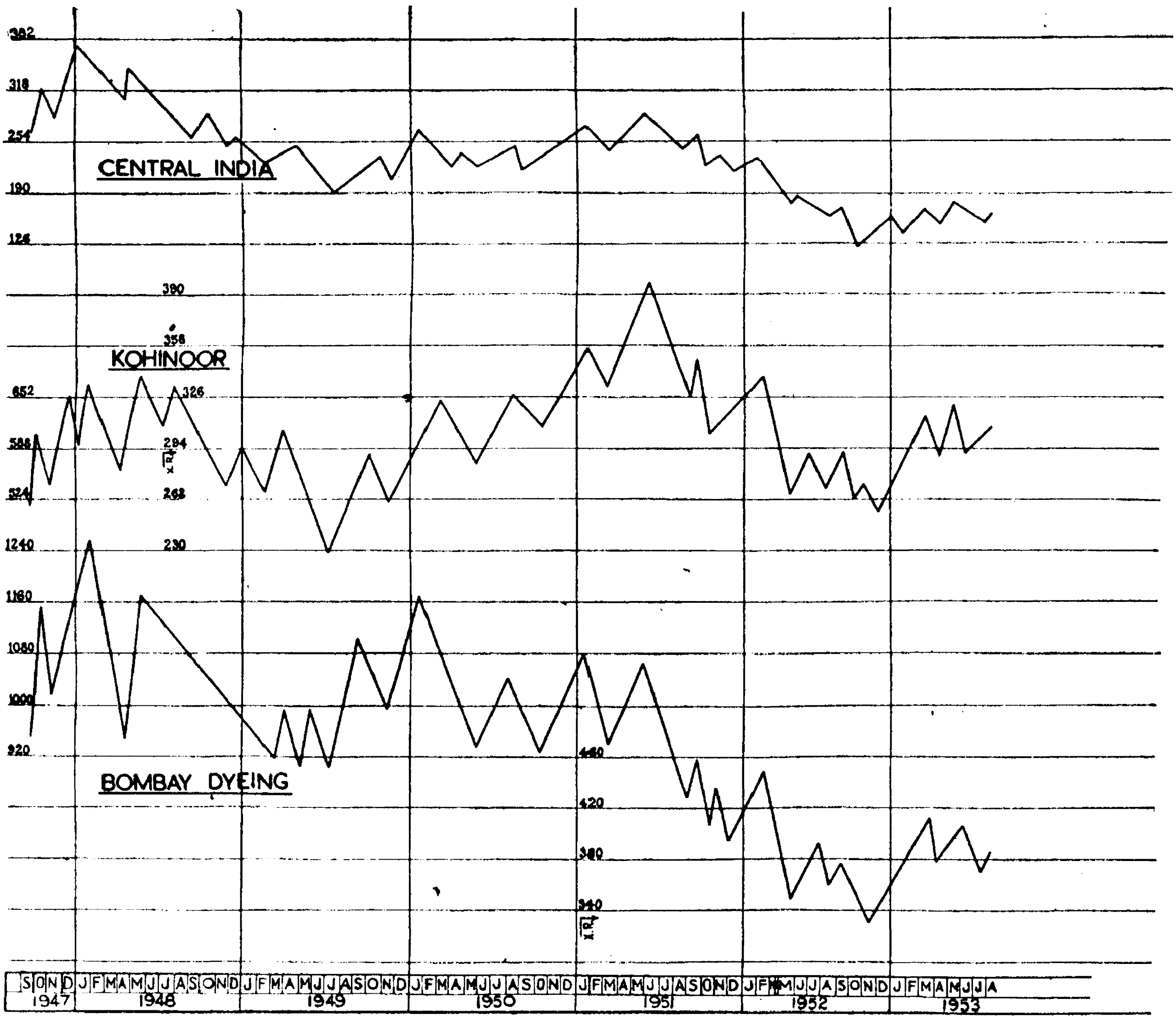
Price Movements in Steel shares

put, declining profits, changing attitude of labour with a rising demand for a share in profits, constant threat of nationalisation and continued anxiety about Indo-Pakistan relations.

The slump in equity prices was phenomenal, and virtually ruined most of the investors. The all-India index for variable dividend securities declined from 289.5 in June, 1946, to 108.7 in July 1949, Bombay index from 278.5 to 117.5, Calcutta index from 278.7 to 100.8 and Madras index from 303.4 to 131.6, The bear cycle which had been in operation for three years ended in July. The reversal of the primary trend reflected satisfaction with the achievement of political stability and the integration of States with the Indian Union, hopes of a more realistic approach to economic problems, tax relief in the 1950-51 Budget and improved trend in industrial production made possible by increased transport facilities and better labour situation. Devaluation helped to improve balance of payments position and Korean war created a near boom atmosphere. Rearmament and stock-piling demand for raw materials led to a marked rise in prices. Inflation tightened its grip on every country. India too had its share of statistical prosperity. By the middle of June, 1951, the all-India index for variable dividend securities had recovered to 140.2, Bombay index rose to 147, Calcutta index to 127.8 and Madras index to 169.4.

The two-year-old bull market ended the day the United Nations and Communist armies decided to cease fire and negotiate for a peaceful settlement of the Korean war in June, 1951. Pending the end of the Korean war economic observers doubted whether armament and stock-piling would slow down appreciably to affect the tempo of world economic activity. But the stock exchange reacted quickly to the peace move in Korea. Industrial shares suffered a heavy setback. Few people then took the verdict of the market seriously. Many critics thought speculators had gambled heavily on Korean peace prospects and had exaggerated the implications. Economists said that the stock exchange had been unduly alarmed by the rising trend in interest rates in India and abroad. The Government thought its disinflationary policy was at last making its influence felt.

The 1949-51 bull market had been based essentially on statistical prosperity following the Korean war. Industrial output had been rising, but rather slowly. The improvement in the balance of payments position had been due less to

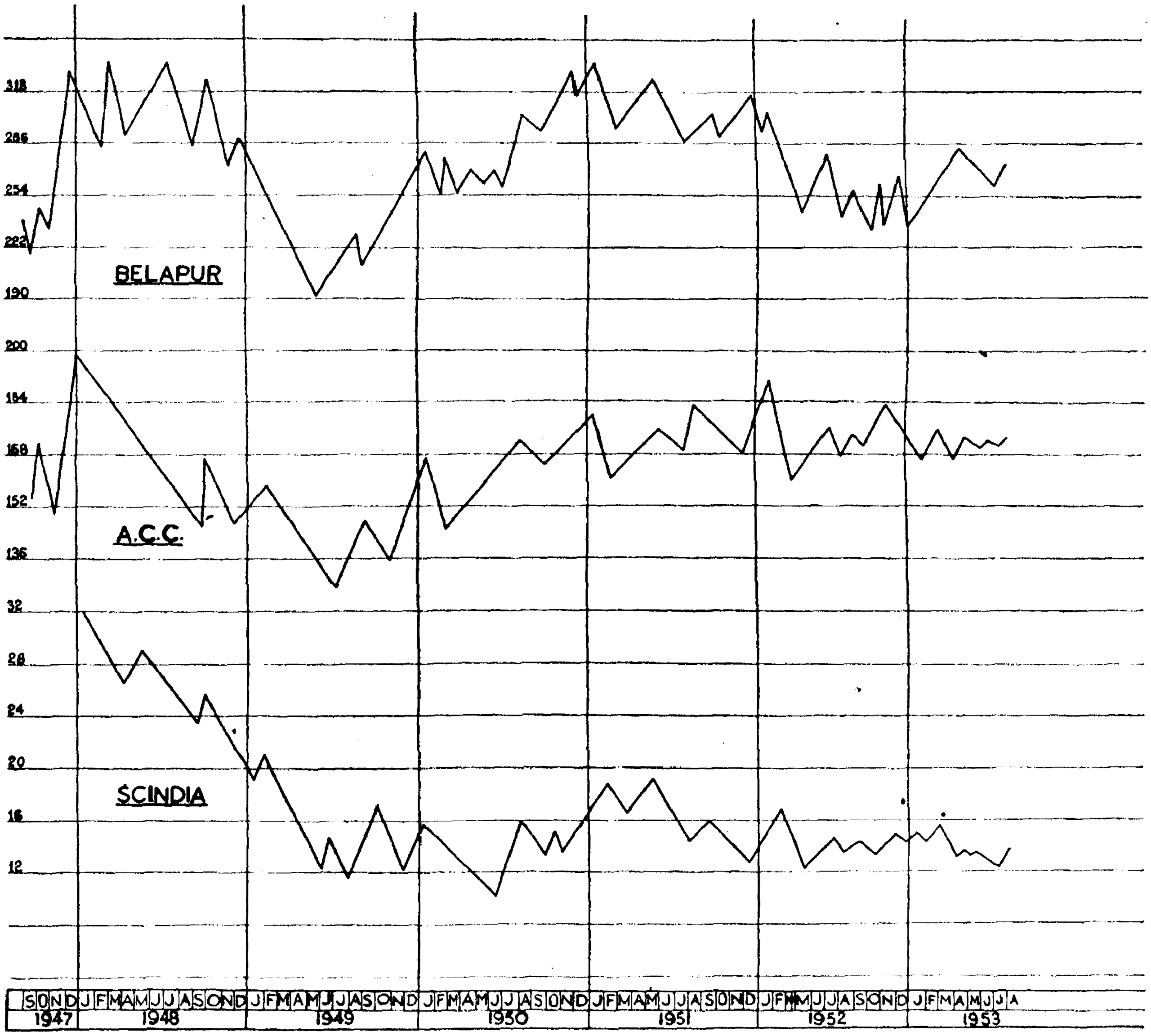


Behaviour of leading Cotton Mill shares devaluation than to cut in imports to check the drain on the sterling area gold and dollar reserves and stock-piling demand. Keen export demand had obscured the competitive power of Indian goods. The bull market ended with the cease-fire in Korea.

Equity prices which had started declining from the last week of June, 1951, took a downward plunge in November because the half per cent rise in the Bank rate brought about a further change in investors' ideas about yield. The primary downtrend was continued for about a year and a half. The all-India index for variable dividend securities declined to 103.3 in January, 1953, against the Korean boom peak of 140.2. Bombay index touched the bear market low of 120.2 in September, 1952. Calcutta index was down to 91 in January, 1953, and Madras index continued to fall until May, 1953, when it reached a record low of 126.2. It is indeed interesting to note that in each major change of trend Bombay gave the lead. Except for Bombay, the 1951-53 bear market pushed down the all-India, Madras and Calcutta indexes to below the 1949 low levels.

Equity prices have been gradually improving for the last few months. This is apparent from the charts of the leading speculative stocks in the Bombay market. Trend theorists are convinced that stock exchanges in India have again resumed the primary uptrend. The chief causes are said to be prospects of economic development under the Five-Year Plan, ideas of deficit financing, rising trend of output in most industries, virtual disappearance of the transport bottleneck and generally satisfactory labour situation, although recent developments at Burnpur have caused some misgivings. The Bombay, Calcutta,, Madras and all-India indexes, which had risen to 128, 95.9, 129.3 and 108 respectively, stood at 125.4, 93.1, 129.2 and 106.2 on August 1.

While the index number for variable dividend securities has shown well-defined bull and bear market movements, the index for Government securities has been making one continuous bear market pattern since 1946. After declining gradually from 106.2 in June, 1946, to 98.1 in November, 1951, the all-India index for Government and semi-Government securities dropped suddenly to 91.4 within a fortnight of the announcement of the half per cent increase in the Bank rate. Later it steadied down to fluctuate between 90.9 and 92.4. The continu-



Fluctuations in Miscellaneous Section—Belapur Sugar, Associated Cements and Scindia Steam.

ous fall in the Gilt-edged market underlined changing pattern of interest rates. Refusal to recognise this change was responsible for the failure of the Government's borrowing programme in the last few years. The terms and conditions of the National Plan Bonds and of the recent State loans indicate the belated realisation of the basic change in the structure of interest rates and investors' preference for short and medium term issues.

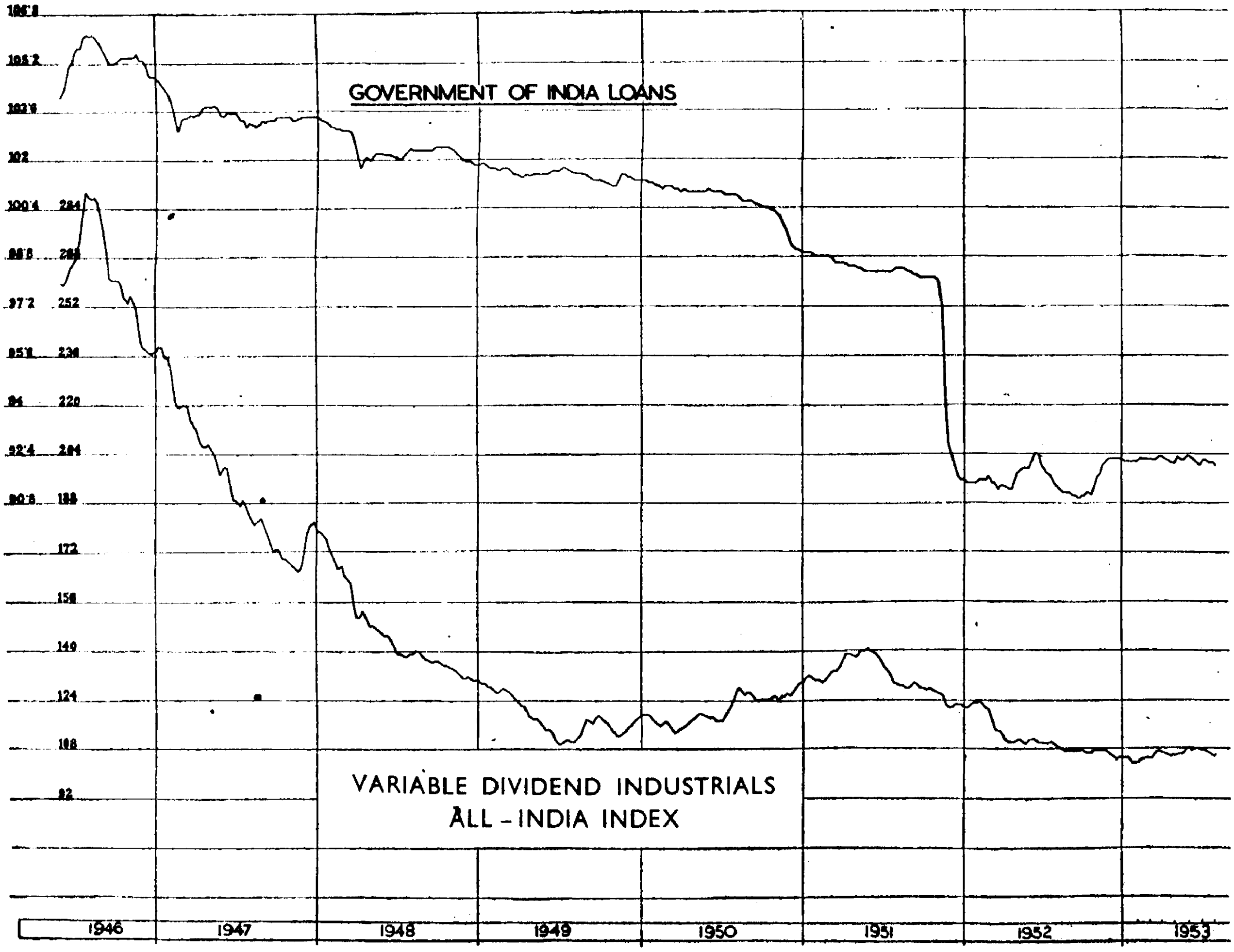
The above review is intended merely to give a broad idea of the primary swings in the stock market. Charts of some of the most active shares in the Bombay market show clearly the important secondary movements. The amplitudes and durations of these movements are by no means uniform because of the varying fortunes of different industries and units in the same industry in" any period" of time. Despite cyclic movements in stock prices, the volume of business has been progressively declining. The fall in the value of the Bombay Stock Exchange membership card from Rs 66,000 in June, 1946, . to the present low level of Rs 18,000 indicates poor business prospects.

The investment market has been virtually- dead for many years. Speculative activity has continued to be the mainstay of the market. Even the most influential and powerful concerns have had to raise new capital through the issue of debentures and preference shares on attractive terms. Many reasons have been given for the continued stalemate in the investment market. The middle classes who are supposed to have constituted the backbone of capital investment in joint stock enterprise have been squeezed out between the enormous rise in the cost of living and the heavy incidence of direct and indirect taxation. The redistribution of wealth in favour of the primary producers and wage-earners who are not used to invest their funds is another important factor.

Investors have been scared by ever-increasing demands by labour to share industry's profits and frequent threats of nationalisation, although the role of private enterprise is generally recognised. The basis adopted for determining the quantum of compensation payable to airline shareholders on nationalisation has caused serious misgivings.

Many thoughtful members of the stock exchange believe that the recent decline in the volume of business in security markets differs radically from the frequently recurrent phases of inactivity in the past. They see in the present troubles indications of deep-seated changes. They believe that the community may soon have to come to grips with a problem of major adjustment. Those determining conditions to which the present system is geared are now seen to have altered basically.

The evidences of the fundamental change are not hard to find. The disappearance of the princely order and the abolition of the zamindari system have been a-great loss to the



Base 1938 = 100. Source: *Reserve Bank Bulletin.*

market. The increasing steepness of progressive taxation has broken up large estates and is exerting similar effects on new accumulations. It is impossible to foresee any sweeping retreat from the general principles of a social policy' which precludes the possibility of building up private fortunes. In recent years all the formerly well-to-do classes of community from whom the valuable stock exchange clients and speculative investors were drawn have been dis-investing.

Whether the saving power of the community is falling may be a moot point. But there is scarcely any doubt about the transfer of the power to save from the few to the multitudes which means a decline in the size of the average private investor. This means more small savings in directions which bring virtually no stock exchange business at all *(eg,* saving certificates, saving bank deposits), more through institutional investors which are largely interested in gilt-edged, and a progressive substitution of small direct investors for the substantial private investors whose investments and speculations constitute the average broker's most remunerative type of business. Leaving aside institutional business which is likely to remain the monopoly of big firms, it must be appreciated that, however many thousands of small direct investors there may be, most of them cannot provide the type of business which can be economically handled by brokers.

If nothing else were involved than a possible reduction in the size of the stock exchange business the public might view the situation with detachment. But much more is at stake than that. The belief is gradually gaining ground that the volume of security business may remain at a permanently low level. This will impair the supply and raise the cost of " risk " capital to industry. The loss of marketability, which is the measure of any deterioration in the stock exchange mechanism, would react upon the profit margins required by entrepreneurs in all types of business enterprise. Moreover, the underlying influences which are destroying marketability arc attacking both the sources of supply of such capital and the incentives to employ it.

. Few people deny India's potentialities for industrial development but the concept of welfare state in an under-developed economy when tree enterprise needs every possible incentive is not considered conducive to the attraction of " risk " capital. At the very outset the entrepreneur is faced with organised labour ever pressing for higher waives. With the change in the concept of economic prosperity industrial expansion is not likely to be accompanied by profit inflation. The existing political and fiscal tendencies are not favourable for accumulation of large private fortunes which alone provided " risk " capital in the past in other countries. Savings in coming years following any possible relief in income-tax and economic development under the National Plans arc likely to be institutionalised. The recent response to the State loans seems to underline this tendency, although their success was due both to favourable terms and conditions and influential canvassing.