Market wisdom
INVESTOR EMPOWERMENT SERIES
LESSON NO.25 • FROM THE HOUSE OF ASIT C. MEHTA INVESTMENTS

History of Indian Capital Markets

The history of the Indian capital markets and the stock market, in particular can be traced back to 1861 when the American Civil War began. The opening of the Suez Canal during the 1860s led to a tremendous increase in exports to the United Kingdom and United States. Several companies were formed during this period and many banks came to the fore to handle the finances relating to these trades. With many of these registered under the British Companies Act, the Stock Exchange, Mumbai, came into existence in 1875.

It was an unincorporated body of stockbrokers, which started doing business in the city under a banyan tree. Business was essentially confined to company owners and brokers, with very little interest evinced by the general public. There had been much fluctuation in the stock market on account of the American war and the battles in Europe. Sir Premchand Roychand remained a kingpin for many years.

Sir Phiroze Jeejeebhoy was another who dominated the stock market scene from 1946 to 1980. His word was law and he had a great deal of influence over both brokers and the government. He was a good regulator and many crises were averted due to his wisdom and practicality. The BSE building, icon of the Indian capital markets, is called P.J. Tower in his memory.

The planning process started in India in 1951, with importance being given to the formation of institutions and markets The Securities Contract Regulation Act 1956 became the parent regulation after the Indian Contract Act 1872, a basic law to be followed by security markets in India. To regulate the issue of share prices, the Controller of Capital Issues Act (CCI) was passed in 1947.

The stock markets have had many turbulent times in the last 140 years of their existence. The imposition of wealth and expenditure tax in 1957 by Mr. T.T. Krishnamachari, the then finance minister, led to a huge fall in the markets. The dividend freeze and tax on bonus issues in 1958-59 also had a negative impact. War with China in 1962 was another memorably bad year, with the resultant shortages increasing prices all round. This led to a ban on forward trading in commodity markets in 1966, which was again a very bad period, together with the introduction of the Gold Control Act in 1963.

The markets have witnessed several golden times too. Retail investors began participating in the stock markets in a small way with the dilution of the FERA in 1978. Multinational companies, with operations in India, were forced to reduce foreign share holding to below a certain percentage, which led to a compulsory sale of shares or issuance of fresh stock. Indian investors, who applied for these shares, encountered a real lottery because those were the days when the CCI decided the price at which the shares could be issued. There was no free pricing and their formula was very conservative.

The next big boom and mass participation by retail investors happened in 1980, with the entry of Mr. Dhirubhai Ambani. Dhirubhai can be said to be the father of modern capital markets. The Reliance public issue and subsequent issues on various Reliance companies generated huge interest. The general public was so unfamiliar with share certificates that Dhirubhai is rumoured to have distributed them to educate people.

Mr. V.P. Singh's fiscal budget in 1984 was path-breaking for it started the era of liberalization. The removal of estate duty and reduction of taxes led to a swell in the new issue market and there was a deluge of companies in 1985. Mr. Manmohan Singh as Finance Minister came with a reform agenda in 1991 and this led to a resurgence of interest in the capital markets, only to be punctured by the Harshad Mehta scam in 1992. The mid-1990s saw a rise in leasing company shares, and hundreds of companies, mainly listed in Gujarat, and got listed in the BSE. The end-1990s saw the emergence of Ketan Parekh and the information, communication and entertainment companies came into the limelight. This period also coincided with the dotcom bubble in the US, with software companies being the most favoured stocks. There was a melt down in software stock in early 2000. Mr. P Chidambaram continued the liberalization and reform process, opening up of the companies, lifting taxes on long-term gains and introducing short-term turnover tax. The markets have recovered since then and we have witnessed a sustained rally that has taken the index over 13000.

Several systemic changes have taken place during the short history of modern capital markets. The setting up of the Securities and Exchange Board (SEBI) in 1992 was a landmark development. It got its act together, obtained the requisite powers and became effective in early 2000. The setting up of the National Stock Exchange in 1984, the introduction of online trading in 1995, the establishment of the depository in 1996, trade guarantee funds and derivatives trading in 2000, have made the markets safer. The introduction of the Fraudulent Trade Practices Act, Prevention of Insider Trading Act, Takeover Code and Corporate Governance Norms, are major developments in the capital markets over the last few years that has made the markets attractive to foreign institutional investors.

This history shows us that retail investors are yet to play a substantial role in the market as long-term investors. Retail participation in India is very limited considering the overall savings of households. Investors who hold shares in limited companies and mutual fund units are about 20-30 million. Those who participated in secondary markets are 2-3 million.

Capital markets will change completely if they grow beyond the cities and stock exchange centers reach the Indian villages. Both SEBI and retail participants should be active in spreading market wisdom and empowering investors in planning their finances and understanding the markets.

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