

# **Speculation Management -- Some Issues**

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Figures relating to the growth of primary capital market in India present an impressive picture. According to the figures, the resources raised by the non-government public limited companies increased eight fold between the fifth and sixth plan periods (1974-75 to 1978-79 and 1980-81 to 1984-85) from Rs. 551 crore to Rs. 4,690 crore. During the seventh plan period Rs. 26,800 crore of resources were estimated to have been raised including Rs. 12,000 crore through PSU bonds. This represents six-fold increase over the resources mobilised through the capital market during the sixth plan period. The trend seems to suggest that it should not be difficult for the market to provide over Rs. 50,000 crore to industry during the eighth plan period<sup>2</sup>.

There should be a healthy and strong secondary market mechanism to sustain this growth of primary market. Because, ultimately it is only the secondary market or stock exchanges that provide liquidity and price continuity for corporate securities. In other words, a healthy secondary market is a prerequisite for smooth functioning of the primary market, which in turn transmits favourable impulses to the secondary market. Again the ability of the corporate sector to raise the required resources from the capital market also depends on smooth and efficient functioning of the stock exchanges<sup>3</sup>.

But available evidence indicates that the performance of the stock exchanges is not in accordance with the role prescribed for them. According to Shri M.R. Mayya, Executive Director, Bombay Stock Exchange, one of the important functions to be discharged by the stock exchanges is providing a market place for purchase and sale of the securities, thus enabling their free transferability. Another major function supposed to be done by stock exchanges is the process of continuous price formation<sup>4</sup>. But recent developments in important Stock Exchanges like Bombay Stock Exchange and Ahmedabad Stock Exchange indicate the failure of the stock exchanges to perform their role efficiently and smoothly.

Intense speculation led payment crises at these stock exchanges and put the exchanges in a complete mess<sup>5</sup>. The Joint Secretary (Investments), Ministry of Finance, says in this connection that, some stock exchanges in the country, particularly Bombay and Ahmedabad, have experienced payments crisis in the recent past. These exchanges have also been experiencing difficulties in the settlement of transactions within stipulated time. On account of these problems, the stock exchanges at Bombay and Ahmedabad had also remained closed for several days. Such a situation is not conducive to the orderly

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2. 'Capital Market', Business and Political Observer, New Delhi, November 20, 1990.

3. Ojha P.D., Investors and the Capital Market, Reserve Bank of India Bulletin, Bombay, December 1987, p. 1141-1142.

4. Mayya M.R. 'Do our Stock Exchanges have a future', Economic and Political Weekly, Bombay, February, 1978 P-M 19.

5. Mehta Anil, 'Committee set up to look into SE's payment problems', Economic Times, February 14, 1991, New Delhi, p.1.

functioning of the stock market and for maintaining investor confidence<sup>6</sup>.

The recent crisis was the outcome of intense speculative operations carried out at stock exchanges for long. Developments at Bombay Stock Exchange provide indications of how speculative forces are influencing stock exchange operations. These developments at Bombay Stock Exchange are very sensitive in nature. These developments assume more significance in the context of the fact that Bombay Stock Exchange is the biggest stock exchange of the country in terms of turnover and number of listed companies.

A close examination of the bullish phase at Bombay Stock Exchange during June-October, 1990 period brings out some important observations. Between, June 1990 and September 1990, Bombay Stock Exchange Sensitive Index (BSESI) registered an unprecedented jump of 83.4 per cent. On June 1, 1990 the BSESI was at 799.5 points and on September 25, 1990 BSESI was at 1466.11 points. Upward march of BSESI continued unabated. On October 9, 1990, it reached 1602.64 points. This jump means 100.4 per cent increase over the June 1, 1990 value. It is noteworthy that such unprecedented increase was taking place during the period of intense political, social and economic uncertainties. To quote Dr. V.A. Avadhani, Director (Training), Institute of Bombay Stock Exchange, "economic and socio-political uncertainties overhanging the stock market had not had any adverse impact on it"<sup>7</sup>.

Between October 89 and September 90 period the share of ACC registered 604.9 per cent jump. Bajaj Auto registered 110.4 per cent jump during this period. Increase in Bombay Dyeing share was also worth noting during October 89 to September 90 period -- 226.8 per cent. Such increase, was clearly indicating that the sharp jumps registered at stock exchange do not have a solid backing of strong fundamentals. In a study on the chemicals and pharmaceuticals industry Dr. V.A. Avadhani, Director, (Training), Institute of Bombay Stock Exchange, concluded that there was a lack of co-relation between the price behaviour of chemical and pharmaceuticals shares and corporate fundamentals. The study which covered the period between March and September 1990 revealed that the bullish trends were out of proportion to the position reflected in the balance sheets of the 77 companies of chemicals and pharmaceuticals business.<sup>8</sup>

Ultimately heavy speculative operations led to a number of problems. To quote a report, "investor confidence has collapsed as millions of small shareholders find that their certificates are barely worth the paper....Nor can they get payment for the shares which they have sold as far back as November last. Those who were fortunate enough to have dealt with the five brokers who were declared defaulters will get a mere Rs. 15,000 as compensation, whatever their losses.....There is also a tendency to create the impression that the amounts involved are minuscule compared to the overall size of the market. A

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<sup>6</sup>. Mehta Anil, 'Committee set up to look into SE's payments problems', Economic Times, February 14, 1991, New Delhi, p.1.

<sup>7</sup>. 'Stock Markets -- The bull mirage', Financial Express, New Delhi, December 17, 1990.

<sup>8</sup>. 'Stock Markets -- The bull mirage', Financial Express, New Delhi, December 17, 1990.

closer look reveals a different picture. From the peak of Rs. 75,123 crore in mid-October 1990, the market capitalisation has fallen to Rs. 59,733 crore-- a loss of nearly Rs. 16,000 crores. Even if 90 per cent of this loss is notional, it still leaves Rs. 1,600 crore, which is the real loss borne by millions of investors...It is common knowledge in the market that there are many more brokers upto 20 per cent of the active brokers, say some, who are suffering some form of payment problems<sup>9</sup>.

There recent developments at BSE should remind us of the observations made by the high powered committee on stock exchange reforms, namely, G.S. Patel committee. The Committee had noted "Exchange speculation on the stock exchanges in India is the root cause of frequent crises and consequent disruption of trading activities and distortion of price structure. In fact the reports of the various committees appointed by the State and Central Governments since 1924, such as the Atlay Committee, the Morison Committee, have all highlighted the problem of speculation..... About 90 per cent of the trading activity on most of the stock exchanges in the country is of purely speculative nature and said to be concentrated on the specified shares numbering about 210 shares about 25 per cent would be relatively more active than the other.....Such concentration of speculative activity in a small number of specified and non-specified scrips, resulting in artificial buoyancy neither provides the correct index of the state of the health of the stock markets nor does it help much in continuity of prices or in broadening of investor interest".<sup>10</sup>

Excessive speculative operations have been putting stock exchanges in a mess for a long. It has been noted that the intense speculative operations are proving to be a serious threat to the meaningful economic relevance and *raison detre* of the stock exchanges. It is interesting to compare the observation made by G.S. Patel Committee with the observations made by National Planning Committee in 1948, around four decades ago: "Viewed at close quarters, in no sense of the term can the existing Indian stock exchanges and share markets be regarded as institutions specialising in providing long-term industrial finance and short-term credit for working expenses. hardly any element in these institutions--they would be more correctly described, if we call them organisation--works deliberately and scientifically as industrial investor or provides advice for intending industrial investor.....No wonder these institutions are favourite haunt to the speculators, who specialise in cornering...It is the most respectable institution offering open facilities for daylight gambling.....If a sound system of industrial financing is to come into being, if our national economy is to be forever rid of this most dangerous plague spot, if the available surplus for investment is to be instantaneously mobilised and scientifically reinvested, the most urgent task before the Indian planning authority is to reorganise fundamentally the structure and working of these honourable asylums for gamblers."<sup>11</sup>

<sup>9</sup>. Bhatia Sidharth, 'Investor confidence in BSE collapses', Independent, Journal of Politics and Business, Bombay, February 1, 1991.

<sup>10</sup>. Ministry of Finance Report of High powered Committee on Stock Exchange reforms, (1985), p.66.

<sup>11</sup>. National Planning Committee report on Industrial Finance, 1948, p.53 to 54. This

The observations made by the Committee around four decades ago and the comparatively recent findings of G.S. Patel Committee establish that due to intense speculative operations stock exchange fail to perform the role as the nexus between community's saving and meaningful investment thereof. Rather they tend to be manipulated by speculative forces putting genuine investment activity in complete mess.

A reasonable level of speculation at stock exchange is not a problem. But excessive speculative operations of brokers beyond their capacity tend to endanger stock exchange operations resulting in a number of problems as faced by investors and authorities at Bombay Stock Exchange. In the words of Shri M.R. Mayya, Executive Director, Bombay Stock Exchange, "The presence of a large number of professional operations with divergent views at any point of time as to the level of prices, with one set of them holding that the prices would rise and the other feeling that prices would fall and acting on such view by buying or selling continuously in the market help to bring about an orderly adjustment of prices. Without these speculative operations a stock exchange can become a disjointed structure, the transactions on which would present a disorderly and aberrated picture with prices displaying wide and hectic fluctuations."<sup>12</sup>

But what actually takes place is excessive speculation, which does not put check on wide and hectic fluctuations; on the contrary excessive speculation fuels hectic and wide fluctuations. It has often been observed that the management of stock exchanges fail to put a firm check on heavy speculative operations. To quote a report on recent Bombay Stock Exchange crisis, "the payment crisis in the BSE is a scandal of Himalayan proportions. The BSE establishment has tried to play it down and even given the impression that a handful of bad boys have failed to come up with a paltry sum of Rs. 7 crore..... The governing board, which is dominated by brokers and has a very poor representation of investors had decided to keep the markets closed till the payment crisis was sorted out. The board first closed the exchange immediately after the Gulf war broke out on January 16, though it was apparent to insiders than that the closure was more to do with broker problems".<sup>13</sup>

The observations of G.S. Committee assume importance in this context. The Committee had observed: "One of the major factors contributing to situations of excessive speculative activity and frequent crises on the stock exchanges is the failure on the part of the governing bodies to enforce strict observance of the rules, byelaws and regulations by the members of exchange.... The system which is followed at present, for the purpose of controlling speculative business such as imposition of margins, levy of penalties and suspension of stock brokers has not been found effective as margins levied are too minimal

Committee was constituted in 1938. Jawaharlal Nehru was its Chairman. Members of the Committee included A.O. Shroff, J.K. Mehta, Purushottamdas Thakurdas, S.C. Majumdar, Dr. P.S. Loknathan, Lal Shri Ram and J.R.D. Tata.

<sup>12.</sup> Mayya M.R., 'Do Stock Exchanges have a Future', Economic and Political Weekly, Bombay, February 1978, p. M-19.

<sup>13.</sup> Bhatia Sidharth, 'Investor Confidence in BSE Collapses', Independent Journal of Politics and Business, Bombay, February 1, 1991.

and are imposed by the governing bodies after the damage is done to the market mechanism of the stock exchange by excessive speculation. Even when the margins are levied, they are not deterrent. In some cases unnecessary leniency is shown to the erring members indulging in heavy speculation, the panalties imposed being negligible."<sup>14</sup>

Management of stock exchanges has failed to effectively cheek the excessive speculative operations. Composition of governing bodies of stock exchanges reveal almost total dominance of brokers. This is one of the reasons of leniency of governing boards towards erring brokers.

The issues relating to management of stock exchanges need serious attention of policy planners and the authorities responsible for administration of stock exchanges. It has been observed that the growth in primary market is not matched by qualitative improvement in the working and management of stock exchanges. The issues relating to management of stock exchanges assume greater significance in view of the fact that there are estimates of raising about Rs. 50,000 crore from capital market through, debentures, bonds and shares.<sup>15</sup> In fact, the responsibilities of stock exchanges are increasing with the increasing investors participation in securities business. But stock exchanges do not seem to respond to these responsibilities. There is a need to develop stock exchanges on the basic broad guidelines which are supposed to give direction to our economic development so that our stock exchanges can play a more meaningful role in our economy. The broad guidelines include that "the basic criterion for determining lines of advance must not be private profit, but social gain and the pattern of development and the structure of socio-economic relations should be so planned they result not only in appreciable increase in national income and employment but also in greater equality in incomes and wealth. Major decisions regarding production, distribution, consumption and investment -- and in fact all significant socio-economic relationships -- must be made by agencies informed by social purpose."<sup>16</sup>

Performance of our stock exchanges indicate that they are yet to become agencies informed by social purpose.

The responsibility of performance of a stock exchange ultimately comes on the governing body of the stock exchange which manages its affairs. It has been observed that governing bodies of stock exchanges remain primarily concerned with the interests of member brokers. They rarely showed concern for the wider interests of investors and healthy investment climate. One of the results of this attitude is that it has not been possible to build up adequately the investors confidence in the functioning of the stock exchanges.

Regarding management of stock exchanges some of the recommendations made by G.S. Patel Committee need immediate attention. The committee said that "the governing

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<sup>14.</sup> Ministry of Finance, G.S. Patel Committee Report (1983), p. 72.

<sup>15.</sup> Dani Hemant `Capital Market -- Task Ahead', Fortune India, December 16-31, 1989, Bombay, p.4.

<sup>16.</sup> Second Five Year Plan p. 22.

body of each of the stock exchanges should consist of elected and non-elected members on a 50:50 basis not exceeding 18 in numbers....The Committee is of the view that so far the non-elected members are concerned, the Government should nominate from the government departments, development banks/institutions, investment institutions, the Reserve Bank of India, economists having necessary expertise in stock and capital markets, industrialists and professionals from recognised bodies such as Institute of Chartered Accountants of India, Institute of Cost and Works Accountants, Institute of Company Secretaries of India, Institute of management etc. The terms of conditions of service of such nominated members should be decided by the Government. The committee notes that one of the reasons for the infrequent attendance of the public representatives at the meetings of the governing bodies of the stock exchanges is that no remuneration is paid to such persons for sparing the valuable time from their other activities. The Committee therefore suggested that such nominated persons should be adequately compensated so that they evince greater interests in the functioning of the stock exchanges."<sup>17</sup> In other words the affairs of stock exchanges are too serious and important to be left to the brokers alone.

G.V. Ramakrishna, Chairman of Securities and Exchange Board of India (SEBI) has also made an important suggestion in this connection. He insists that SEBI should have the right to appoint the executive director of stock exchanges. The executive director is at present influenced by the brokers who normally dominate the boards in nearly all the stock exchanges. A powerful executive director on the board dominated by professionals can take even tough decision which he today finds difficult.<sup>18</sup>

In fact, an effective SEBI can play an important role in the improvement of the working and management of stock exchange by putting an effective check on undesirable activities like excessive speculation not handled effectively by the authorities at present. But SEBI established in April, 1988 is yet to get the statutory power to deal with various aspects of operations of stock markets.<sup>19</sup>

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17. G.S. Patel Committee Report (1989), p. 24.

18. Sharma Sumit, 'Regulating Capital Market', SEBI Chief for Comprehensive Law, Financial Express, New Delhi, October 3, 1990.

19. G.S. Patel Ex-Chairman of Unit Trust of India and Chairman of high powered Committee on Stock Exchange reforms wrote in Fortune India, Bombay, December 1, 1990. p.22, that 'Entrenched vested interests in the government and outside, particularly in the institutions and stock exchanges are trying desperately to ensure that SEBI is not endowed with such overriding powers as may ultimately be detrimental to their self interest. It is mainly because of such unwarranted opposition from the vested interests that neither adequate powers are being conferred on SEBI for regulation and control of the securities industry nor is any comprehensive legislation being passed to enable SEBI to govern the various aspects of the security industry and those closely associated with it.....'