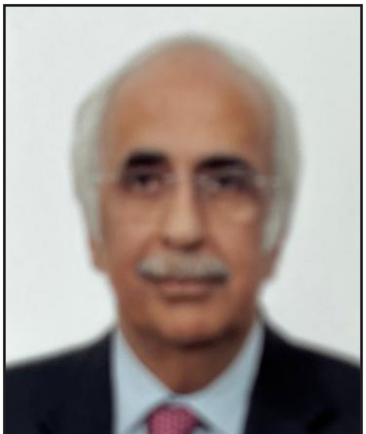
Forty Years of the Capital Market



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It was mid1984- exactly four decades ago. I had opted for deputation to the Government of India and found myself in the Department of Economic Affairs as a Deputy Secretary and ex- officio Additional Controller of Capital Issues. I had scant knowledge of the stock market or what the office of the Controller of Capital Issues (CCI) did. That, I suppose, is how the system works - the least knowledgeable person is drafted into that role!

The Capital Issues (Control) Act was a post-war legislation enacted for keeping a check on the moneys raised by the corporate sector with the objective of conserving scarce financial resources. It may have outlived its objective but continued to operate. No capital issue could take place without the consent of the CCI; the premium, if any, was specifically approved; the range of instruments was limited and largely restricted to equity. The formula for determining the premium on share issues was a simple average of the Net Asset Value and of the Profit Earning Capacity Value discounted at a fixed rate. Capacity in the government to handle the proposals was adequate to apply the prescribed parameters but not for creative innovation; that was not on the table either.

Ideas and new instruments came from Bombay (now Mumbai) from the small community of three or four merchant bankers. Thus, were born Debentures- fully convertible and then partially convertible - but the interest rate was capped. We thought the market was booming when in FY 1985 the amount raised from the market was the princely sum of a little more than Rs 100 crore! The then Finance Minister was duly apprised of this and he recorded on file his appreciation of the good work that the CCI team had done. Forty years later that number seems from another world. Today the market capitalisation of shares listed on the National Stock Exchange is over Rs 4 lakh crore or about $ 5 trillion. As against the Rs 100 crore of FY 1985, it is estimated that more than 50 firms will raise about Rs 70,000 crore in FY 2025.

The winds of change came slowly but definitely. It was felt that the Capital Issues (Control) Act and its implementation worked to the advantage of small investors but did not help in the growth of businesses. The opening up of the economy required a new regulatory framework. Thus was born the Securities and Exchange Board of India (SEBI) in April 1988; it got statutory powers from the SEBI Act of 1992 and the Capital Issues Act was repealed. The transition between the two regulators led to the inevitable manipulation for some time. Since the pricing of shares had been free, many promoters took undue advantage. Cynics would say that that these fly - by - night promoters who rode two-wheelers suddenly had the money to buy a number of cars - one for themselves, one for the spouse and one perhaps for the dog!

SEBI's role as enshrined in the preamble to the Act is both to develop and to regulate the capital market. The first ten to fifteen years of the thirty that SEBI has functioned as a statutory regulator were more focused on its developmental role. As in the case of other economic regulators, SEBI has three powers: executive, legislative and judicial. It drafts regulations in its legislative capacity, conducts investigation and takes enforcement action in its executive function and passes orders in its judicial role. Though this trinity gives it wide powers, there is an appeal process to the Securities Appellate Tribunal (SAT). A second appeal lies to the Supreme Court.

Three decades old, SEBI has acquired credibility as an effective capital markets regulator. It is also recognised as such by the community of stakeholders and peer group regulators. SEBI has enjoyed success by pursuing systemic reforms on a continuing basis. It pushed quickly towards making the market electronic and paperless. Physical securities were done away with by passing the Depositories Act. Consequent to miscarriages due to manipulation, the disclosures to be made by corporates has been made more robust over time. Despite its decent track record, SEBI finds itself in the crossfire from time to time. There have been half a dozen major scams during its life of thirty years. Market intermediaries have now and then brought it a bad name by fraudulent activities resulting in losses to investors. Insider trading cases and delays in their detection and punishment is another aspect highlighted by critics.

Three other areas of concern cannot be overlooked. One is the time taken in disposal of matters which come to its attention. Internal capacity cannot be a defence given that it has had a reasonably long time span already. The second and more serious issue is the perception that in some cases SEBI over-does and in some others it under-does. While this may not be entirely correct, perception among stakeholders is important in determining the level of trust that it enjoys. Lastly, it is seen as constantly tinkering with the regulatory architecture rather than following the dictum: "don't fix it, if it ain't broken".

A final word about accountability. Given the wide sweep of powers that SEBI, or for that matter all economic regulators enjoy, it would be desirable to institutionalise an arrangement where a Standing Committee of Parliament has an annual detailed review of its functioning. It may be argued that this will curb the autonomy of the regulator. On the contrary, this would move the needle from mere executive oversight to an arrangement which can be expected to be more broad-based. Further, largely informal interventions will be replaced by a formal review of the functioning of the regulator and it will be made public through the report of the Parliamentary Committee. Suggestions and directions would then flow and provide a matrix for work in the year ahead. This would help to strengthen the regulatory framework and help in taking the capital market to still greater heights. Needless to say, a vibrant market is a surrogate for a robust and dynamic economy.