Capital and Financial Market reforms in the Corporate Sector in the changing Scenario

(Address as Chairman Dr PS Lokanathan Memorial Society in the inaugural session of the seminar at Bombay on 16-06-95)

Of the various factors of production Capital assumes a more important role in the context of competition from giant and multinational Corporations. With adequate capital, it would be possible to procure the best raw material, the most skilled labour and the best managers, Sickness in a number of small scale enterprises is traceable largely to inadequate capital for working expensesand inordinate delay in providing accommodation by the banking services.

At the dawn of independence, the country was faced with an enormous backlog of infrastructural facilities like power, transport and basic industrial raw materials like steelmetals and minerals. There was no capital market, no stock exchange worth the name; Capital was shy and investment was largely in money lending and agriculture, Industrial enterprises had no access to Euro loans, foreign direct investment and the like. Private sector could not start giant projects (in those days) like million ton steel plant or a Neyveli Lignite venture.

It was in this context that the State came in a big way with massive investments in Steel, Fertiliser, and Power etc. The State was able to raise resources from abroad to augment the meager savings within the country. The country saw massive industrial development during the plan periods. A vibrant Private Sector also grew side by side ready and able to take over further industrial growth with their own resources and efforts. Economic liberalization without a capital market and entrepreneurial class failed in the Soviet Union, while economic liberalization in India has been a success. Today the private sector is able to mobilize internal and external resources, generate foreign direct investment , and attract foreign collaborations in sophisticated technologies, The private sector has come of age and need to fill the gapby direct state intervention has disappeared. The draught having been eased, draught relief can be withdrawn, Continuance of the public sector is now nothing but the persistence of an old habit.

The prime source of Capital is national savings. Other sources like foreign loans, grants and aid are only ancillaries. National Savings comprise of:

1. Government savings *i.e* surpluses from current revenue and other receipts.
2. Corporate savings *i.e* surpluses from th Public and Private enterprises including depreciation and profits and
3. Hosehold savings by the masses of the people.

Modern budgeting is a statement of receipts and disbursements and not of income and expenditurein the etymological sense. The dictionary meaning of income is money received periodically or in a year from one's <u>work</u>, <u>lands, investments</u> etc. Loans are not income. We do not pay income tax on loans obtained. The budget shows loans and borrowings as income and presents a surplus or deficit on that basis. The shape of the economy is reflected by the fiscal deficit and not by budgetary balances. It is only in recent years that we paid attention to the persistently high fiscal deficit of our country. But we have been unable to tame the shrew. The fiscal deficit for the year 94-95 is estimated at 6.7% of the GDP.

Corporate savings from the Public Sector has been negligible. While some Public Sector enterprises have done remarkably well, the overall picture is gloomy. Prof S L Rao has cited in one of the papers here before us that the investments in PSEs (1993-94) amount to Rs 1,46,971 crores and that the return by way of dividends and interest is 2.69%. The abnormality will be realised when the interest paid by the Central Government on their public debt is 9%.

Private Sector corporate savings depend on the rate of growth which is now taking a turn for the good. But that alone is not sufficient to sustain the capital needs of the Industryand Commerce.

Household savings are the backbone of investments. If there is a steep fall in household savings, the Capital markets will be seriously hampered. The eighth plan envisages domestic savings of the order of about 800000 crores during 1992-97 at 1991 prices. The CSO estimates however reveal a steep fall savings.

Inflation is the enemy of household savings. Ever increasing cost of necessities of Life leaves very little margin for Savings and consequently very little net additions to capital formation.. All endeavours to mobilize savings will be futile. If there are no savings at all.

The top layer of Industrial and mercantile community is net borrowers. The people below poverty line can not save. The rural savings have not been properly tapped. It is only the urban and semi-urban middle class that has the urge and capacity to save. Hence the target group for mobilizing savings should be rural and urban middle class and efforts should me made to reach them.

The theory that rural people are not interested in productive investment is an old myth. Most of the textile mills in Coimbatore were built in the thirties with deposits from rural land owners. They used to deposit moneys with the promoter of the Mill , relying on his rectitude and withdraw as and when they wanted with the interest accrued up to that date. There was no term deposit and no differential rates of interest related to the period of the deposit. The villager shuns fixed deposits as he is afraid he cannot withdraw the amount when there is a domestic need.

The savings bank is totally unattractive in rural conditions of private lending. Suitable instruments should be framed to attract rural savings for economic development from 70% of the people of whom at least a third are potential savers.

Long term savings like Public Provident Fund and Life Insurance yield negative returns to the investors. Over a period of 20 years the erosion of the Rupee is such that the investor gets only tenth of his investment in real terms. Suggestions of indexing long term savings have been made from time to time but that is beyond the realm of practicality.

Of late Stocks and Shares have become SHOCKS and SNARES. The pricing in secondary market bears no relation to the yield and therefore does not interest of the genuine investor who wishes to augment his Income for current expenditure. Several vices have surfaced in recent years that secondary market has become the hunting ground of gamblers. That the financial Institutions also join the game of speculation is regrettable. At a time when market mobilization of Capital was difficult, the financial Institutions helped entrepreneurs by subscribing for Equity capital. In the present context , the financial institutions should confine themselves to only lending and refrain from meddling in management which equity holdings enable them to do. Time was when government itself insisted on allotment of shares to financial institutions as a condition for granting loans. That was a time when the doctrine of social control prevailed. Such compulsions are alien to our new economic policy.

The primary market is a good source of market capitalization. Here the high premium charged and priority allotments to financial institutions, mutual funds and the Neo Bridegroom the NRI elbow out the small investor. We swear by competitive economy on the one hand and demand preferential treatment on the other. In order to encourage the small investor, the preferential allotments must be abolished and the Institutions should be put on par with the rest.

There are large investible funds with the pension and the Provident Funds and charitable Trusts but they are subject to restrictions in deploying their funds.On the analogy of the developed countries, suggestions have been made for removable of those restrictions and for free investment in the corporate sector. Prof S. L. Rao, for whose erudition I have great regard, has also advocated the withdrawal of restrictions in his excellent theme paper, which has been circulated among the participants.

A nation has to frame its policies on the basis of national psychology and not on external models. If a Private Banks fails, if the Private Provident Fund defaults, the nation accuses the Government for not regulating them adequately. The government is blamed for even a private person's misbehaviour like misappropriation and fraud. The concept of a State affording paternal protection handed down by tradition from the days of benevolent kings of ancient golden era still persists. With the chaotic conditions in the stock market, if the pension funds suffer a setback, people of India will charge the government with neglect and force it to impose more stringent conditions. I would advise caution in deployment of such funds.

One of the things which might deter gambling in stock market is to reduce the period of settlement to four or five days. Long settlement dayes often enables the speculator to totally avoid settlement by dexterous change of portfolio before the settlement date.

The second suggestion I would make is that when share prices spiral up by speculative activities, the Stock Exchange should resolve to clamp a ceiling on prices and withhold trading above the price. The ceiling price should bear relation to the yield, NAV growth prospects etc.

Likewise when BEARS depress the market a floor price should be fixed by the Stock Exchange itself and trading on those shares suspended in the Stock Exchange.

Finally unproductive expenditure of the State and Central governments are mounting at an catastrophic rate. One item in the earlier financial statements , namely, surplus from current revenues has disappeared and large deficits are staring at the face. I once told the Planning Commissions that the size of the Plan should be the sum-total of:

1. Surplus from current revenues
2. Surplus from P S E S

3. Additional resource mobilization
4. Internal and External borrowings and
5. a small dose of deficit financing.

We are borrowing to meet our current expenditure and increasing our debt and interest burden. When I presented the budget for 1981-82, the Revenue deficit was 0.2% of the GDP. Ten years later, it is 2.8% of the GDP in 1991-92. All our efforts towards financial and fiscal reforms will go awry unless we eliminate revenue deficits and bring down fiscal deficit.

One becomes suspect when one reduces direct taxes on those who have the capacity to pay and pleads for abolition of subsidies on essential articles of consumption by the masses. Such policies will spell ruin to the political parties in Indian democracy.

I have made a few observations more to excite a vigorous debate than to enunciate conclusions. Eminent economists, heads of financial institutions, administrators and industrialists have gathered round the table to provide guidance to the nation regarding policy and administrative changes necessary to make our transition from a controlled economy to a free market economy a success. I have every confidence that the meet today and tomorrow will help the nation march forward to its goal.