

REPORT ON THE REGULATION OF
THE STOCK MARKET IN INDIA

-- P.J. THOMAS
(1948)

INTRODUCTION

Stock market activity in India reached its highwater mark during World War II. The number of stock exchanges trebled (from 7 to 21), and in many cities street markets and many outside brokers sprang up to participate in the rapidly expanding trade in securities. When opportunities for speculation in commodities were narrowed down by the promulgation of the Defence of India Rules, idle money found its way increasingly into stock market speculation. To prevent this, Defence Rule 94C was promulgated in September 1943, but this had not the desired effect. It even made matters worse by driving out business from regulated to unregulated markets, thus causing excessive speculation. As the D. I. R. was bound to lapse after the war, it was necessary to decide whether any peace-time regulation of the stock market should take its place. It was for helping Government to make a decision in this matter that this enquiry has been undertaken.

The enquiry soon disclosed a serious state of things in the stock market, one which clearly demands Government intervention in the public interest. At the start it was the stock exchanges that attracted sole attention, but it soon became clear that much of the trouble came from outside markets and from powerful outside operators (including some company directors) who are able to utilise the stock market for their selfish ends. What with the many rival stock exchanges competing with one another in the same town, and with street markets and independent firms pursuing methods calculated to undermine whatever regulation has been attempted by the stock exchanges, the Indian stock market is today in a very unorganised, even confused, state: it may make one wonder how this country which has concentrated so much on law and order has allowed disorder to continue in so important an economic field.

Not only the organisation of the stock market was found defective; its functioning has also often been detrimental to the interests of investors and of the national economy as a whole. Safety for dealings is largely non-existent and proper provision does not exist for equity between parties. Perhaps the most objectionable feature is the violently fluctuating character of prices in the stock market. This has also worked to the detriment of the investing public. Occasionally the market is pushed up by reckless bull operators to unwarranted heights, and the crash that necessarily follows leads to wide-spread liquidation and loss; even such a pitiable situation, let it be noted, is utilised by powerful bear syndicates to hammer prices down and to extort as much money as possible from investors by causing panicky selling in the market. This has been going on for long in the Indian stock market; this is in fact what has happened between March 1946 and May, 1947, during which period the market has gone through both these phases, bringing large profits to speculators but causing vast losses to the investing public. No doubt political uncertainties and communal wranglings had been at the bottom of the nervousness in the stock markets lately, but it cannot be denied that selfish bear operators have been aggravating such panic and making capital use of it to their selfish advantage.

What has been described above, cannot now happen in the leading Western countries, and much less in Japan or Australia; because their governments keep a tight control over the working of stock exchanges

and forcibly curb every effort of speculators to reap profits at the cost of the investing public. But in India owing to the stolid *laissez faire* attitude which has long prevailed, Government has not so far seriously concerned itself with the work of stock exchanges. In the result, powerful vested interests have been created, and those have been allowed to utilise the investment market for their selfish profit.

Many people cannot understand why the trade in the companies' shares should be controlled, while the trade in the goods produced by the companies is not normally so regulated. They cannot understand why the stock market should not be free to regulate itself, as most other markets are. They do not realise that the investment market is engaged in a work of great public importance. Perhaps not so clear to them are the many-sided repercussions of the stock market on the price level, on the credit system, on banking and on the national economy as a whole. It has to be realized, as the U. S. A. came to realize at great cost, that "The stock market is an integral and inseparable part of the national financial system, as important as the banks themselves." To leave to private and unsupervised control an economic institution so intimately tied up with the gears that drive the wheels of industry and business, is a serious dereliction of public duty. And who are the parties that now dominate the stock market? Speculators whose interests collide directly with those of the public, and company promoters and directors who seek to get rich quick at the cost of shareholders and investors generally.

It is true that in many countries regulation came only after some catastrophic events. Only after the fatal Wall Street crash of 1929 and a serious banking crisis which resulted in the closing of half the number of banks in the U. S. A. did the people of that country make up their minds to carry out energetic Federal measures for controlling the stock market. But it is not the path of wisdom to wait till the worst happens. There is a wise old saying in this country that it is better to keep the feet free from mire rather than allow them to wallow in mud and then wash them.

Although India has not had to pass through anything so catastrophic, the experiences in India since 1943 are adequate to carry conviction that the stock market has to be regulated in the national interest. A Defence of India regulation was indeed promulgated in war time, but as will be shown in the Report it was in no way a success. Although it is now nearly two years since hostilities ended, conditions in the stock market are still such as to call for stringent regulation even now. Since March, 1946, the stock market has passed through various phases—first a boom, then a crash and prolonged depression. All these tendencies could have been kept under control, had there been a proper authority regulating the stock market in times of need, and co-ordinating the work of its different sections which often function at cross purposes.

The regulation is needed not for hindering the working of the forces of supply and demand, but for preventing such forces being manipulated by selfish operators for private profit. There are still those who pin their faith on the sanctity of the market, but it is for them to show how far the market conforms to the pattern they have in mind. Those, who point out how free the London Stock Exchange is, have to recognise that the intensity of internal discipline on that exchange has made outside interference unnecessary. Can any one make out a similar claim for the Indian Stock Exchanges?

It is not merely the safety of the investor that has to be taken into account. The question is much wider. Our immediate national concern

is the planned economic development of the country for eradicating the miserable poverty of our people. The crux of all economic progress is capital development and as complete nationalisation is not practicable, corporate enterprise has to be utilised for the expansion of economic activity. The issue and sale of stocks and shares is therefore of prime importance to economic planning, and unless this is properly regulated in the public interest every attempt at planned development will only put more money into the hands of the few rich persons who have already flourished by anti-social means. In this light, the rectification of our investment market is an essential preliminary to the launching of any plan for economic development.

The present report deals with the principal aspects of the problem and suggests measures which call for urgent consideration. The first of these measures is Central legislation and the second—equally important—is the setting up of a competent public authority to administer the law, because in the absence of suitable machinery for this purpose, the most perfect legislation may be futile and may even prove injurious, as shown by war-time experience in India. It has also been shown that only a Central (Federal) authority could administer such law effectively.

Acknowledgements.

When this enquiry commenced, hardly any published material was available on the subject (except the two Bomay Committee reports, which deal with only a single stock exchange). Evidently the subject has not so far received any serious attention from economists and financial experts. Nor are the stock exchanges themselves interested in readily supplying information. When an industry seeks protection, it supplies all relevant data to the Government or the Tariff Board. But in the present case, the stock exchanges have sought no protection; it is the public that stand in need of protection against the stock market. In spite of the lack of such incentive, most stock exchanges have sent replies to my questionnaire, but as the replies did not give adequate details on important points special enquiries had to be carried out for the purpose. A Research Officer was sent out to various centres to collect information locally. Enquiries were also made by correspondence. I must express my gratitude here to the Presidents of various stock exchanges, especially those of Bombay and Calcutta, for their courtesy in answering my queries. Several members of the public have also sent me data, whether in reply to my queries or of their own accord, and I am grateful to them also. None of these, however, is responsible for any of the opinions expressed in this report. I take sole responsibility for them.

When the Twentieth Century Fund Inc., of the U. S. A. decided to carry out a survey of American security markets in 1934, they employed for this work thirty economists with twenty assistants to help them and there was besides the expert staff of the Fund itself. Such an elaborate survey has not been possible here, and the staff allowed me for this enquiry consisted of one Research Officer (Mr. P. K. Panikkar) and even this only till the end of October, 1946, when the drafting of the report had only started. The data collected by him in the course of his tours and his notes have been of great use. I had also the assistance of one Research Assistant (Mr. T. N. Joseph) who, although engaged principally in another piece of work, was able to find time for assisting me in the statistical part of this work. These two gentlemen worked unsparingly to help me in this difficult work, and I am sincerely thankful to them.

Finally, I shall be failing in my duty if I do not express here my heavy debt of gratitude to the President of the New York Stock Exchange and to the U. S. Securities and Exchange Commission, Philadelphia, for enabling me to study the American system of stock market regulation, first when I visited them in 1945 and subsequently by answering my many queries.

P. J. T.

3rd July, 1947.

TABLE OF CONTENTS.

CHAPTER I.

Page

HISTORY AND PRESENT POSITION OF THE INDIAN SECURITY MARKET.

A. Historical Survey—

| | |
|--|-------|
| Beginnings of the Indian Security Market. | 1-2 |
| Bombay Stock Exchange. | 2 |
| Calcutta Stock Exchange. | 2 |
| Ahmedabad Stock Exchange. | 2 |
| World War I and After | 2-5 |
| Atlay Committee Enquiry and Bombay Legislation | 2-3 |
| Period of Expansion 1934-35. | 4 |
| Morison Committee Enquiry 1937 | 4-5 |
| Crisis in Calcutta Market 1937. | 5 |
| World War II. | 5-8 |
| Minimum Prices. | 5-6 |
| Control of Forward Dealings. | 6 |
| Growth of Outside Markets. | 6 |
| New Exchanges. | 6-7 |
| Share Boom (1946) and Slump (1947). | 8 |
| B. Security Market in India—Composition. | 8-10 |
| Curb Markets; over-the-counter Markets. | |
| C. A Bird's-eye-view of the Stock Market. | 10-12 |

CHAPTER II.

| | |
|---|--------|
| CONSTITUTION AND MANAGEMENT OF STOCK EXCHANGES. | 13-24 |
| Constitution. | 13-19 |
| Private Associations. | 13, 14 |
| Company Exchanges | 14, 15 |
| Membership Rules | 15-17 |
| Membership in Practice | 17 |
| Partnership | 18 |
| Brokers and Jobbers | 18 |
| Tarawaniwalas | 18-19 |
| Remisiers | 19 |
| Management | 19-21 |
| Governing Boards—Composition | 19, 20 |
| Management of the Company Exchanges | 20 |
| Committees | 20, 21 |
| Rules and Regulations | 21-23 |
| Listing Regulations | 22, 23 |

APPENDIX TO CHAPTER II:

| | |
|--|----|
| Number of Members of Stock Exchanges | 24 |
|--|----|

CHAPTER III.

| | Page |
|--|--------|
| THE SECURITIES | 25—39 |
| Paucity of data | 25 |
| Public Securities | 25 |
| Other Stock: | 26—31 |
| Listed Securities | 27—31 |
| War-time Prices of Stock | 31—34 |
| Aggregate value of Securities | 34—36 |
| The ownership of Stock | 36, 37 |
| The Stake of the Nation | 36, 37 |
| APPENDIX TO CHAPTER III: | |
| A. Number and Capital of Joint Stock Companies | 38 |
| B. Government and other Public Securities | 39 |

CHAPTER IV.

| | |
|---|--------|
| OPERATIONS OF SECURITY MARKET | 40—58 |
| Cash Market and Forward Market | 40—42 |
| Position in India | 41, 42 |
| Course of Cash Dealings | 42, 43 |
| Bombay | 42, 43 |
| Calcutta | 43 |
| Madras | 43 |
| Course of Forward Dealings | 43, 44 |
| Contracts | 44, 45 |
| Settlement and Clearance | 45—48 |
| In Cash Dealings | 46—48 |
| In Forward Dealings | 48, 49 |
| Buying in and Selling out | 49, 50 |
| Budla or Carry Over | 50, 51 |
| Parties accommodating each other | 50, 51 |
| Budla through Intermediary or Budliwala | 51 |
| Transfer of Securities | 51—54 |
| Blank Transfer | 54 |
| Margin Trading | 54—56 |
| Short-Selling | 56—58 |

CHAPTER V.

| | |
|--|--------|
| SECURITY MARKET AS IT SHOULD BE | 59—67 |
| Raison d'être of Security Market | 59, 60 |
| Functions of the Security Market | 60—63 |
| Liquidity and Price Continuity | 60, 61 |
| Evaluation | 61 |
| Safety in and Equity for Dealings | 61, 62 |
| Direction of Savings into the most Productive Channels | 62, 63 |
| Speculation | 63—65 |
| Speculation has its uses | 63 |
| Importance of Speculation exaggerated | 63 |
| Speculation in Commodities versus Speculation in Stock | 64 |
| Speculation can be misused | 64, 65 |
| Speculation as it should be | 65—67 |

CHAPTER VI.

| | <i>Page</i> |
|---|-------------|
| SECURITY MARKET AS IT IS | 68—84 |
| Stock Exchanges | 68—75 |
| Excessive Speculation | 68, 69 |
| Faulty Settlement methods | 69 |
| Evils of Budla | 69 |
| Easy Credit Facilities | 69, 70 |
| Private Compromise | 70 |
| Forward Dealings and Speculation | 71, 72 |
| Equity in Dealings | 72—74 |
| Lack of Rules and Laxity in Enforcement | 74, 75 |
| Street Markets and Share Bazaars | 75—77 |
| Repercussions on Stock Exchanges | 75—77 |
| Independent Firms and outside Brokers | 77—80 |
| Their Business enmeshed with that of Stock Exchanges | 78, 79 |
| Multiple Trading | 79, 80 |
| Arbitraging | 80 |
| Manipulative Activities of Outside Operators | 81—84 |
| Manipulation—general | 81 |
| Manipulation by Unfair Use of Inside Information by Company Directors and Officers | 81—84 |

CHAPTER VII.

| | |
|---|----------|
| THE ECONOMIC RESULTS OF THE SECURITY MARKET | 85—101 |
| Has Security Market fulfilled its Functions? | 85 |
| Wide Fluctuations in Security Prices | 85 |
| Comparison with Fluctuations of Prices abroad | 85—87 |
| Price Fluctuations in India | 87—90 |
| Safety for and Equity in Dealings | 90 |
| Any Set back in Investment Habit? | 90, 91 |
| Effect on the Credit System | 91, 92 |
| Stock Market Crisis and Banking | 92 |
| Widespread Tax Evasion | 93—95 |
| Contract Stamps | 93, 94 |
| Transfer Stamps | 94 |
| Income-tax | 94, 95 |
| The Outcome | 95—97 |
| Causes of the Evils | 96, 97 |
| Lack of Experience and Training | 96 |
| Craze for Gambling and Speculation | 96, 97 |
| APPENDIX A.—Index Number of Security Prices in U. K., U. S. A. and India | 97—99 |
| APPENDIX B.—Aggregate value and aggregate dividend of Ten Securities | 100, 101 |

CHAPTER VIII.

| | |
|---|----------|
| SHOULD THE SECURITY MARKET BE REGULATED? | 102—112 |
| Abolition of Stock Markets and Speculation? | 102 |
| Speculation has to be controlled | 103 |
| Regulation, an Invasion of Private Right? | 103, 104 |
| Need for Control in the Public Interest | 104 |
| Ineffectiveness of Government Control? | 104, 105 |

| | <i>Page</i> |
|--|-------------|
| Stock Market Control will hit Indian Industry? .. | 105, 106 |
| Example of Japan .. | 105, 106 |
| Stock Market favours Control .. | 106, 107 |
| Inadequacy of Partial Control .. | 106, 107 |
| Stock Exchanges also must be brought under Regulation .. | 107, 108 |
| Government's responsibility in regard to Price Fluctuations .. | 108—110 |
| Ultimate Aim .. | 110 |
| Government Regulation in Bombay since 1926 .. | 110, 111 |
| Central Control in War Time .. | 111 |
| Need for Regulation still exists .. | 111, 112 |

CHAPTER IX.

| | |
|--|----------|
| METHODS OF CONTROL IN OTHER COUNTRIES .. | 113—121 |
| London .. | 113, 114 |
| Amsterdam .. | 114 |
| Paris .. | 114, 115 |
| Berlin .. | 115, 116 |
| Tokyo .. | 116 |
| New York .. | 116—118 |
| Lessons from Abroad .. | 118 |
| India and the U.S.A.—Comparative Position .. | 118—121 |

CHAPTER X.

| | |
|--|----------|
| NATURE OF REGULATION .. | 122—132 |
| Work before Government .. | 122 |
| Need for Effective Administration .. | 122, 123 |
| Example of the U. S. A. .. | 123—126 |
| Control of Manipulation .. | 123, 124 |
| Control of unfair use of Inside Information by Company .. | 124 |
| Directors and Officers .. | 124, 125 |
| Regulation of Over-the-counter Markets .. | 125, 126 |
| Re-organisation of Stock Exchanges .. | 126 |
| The Problem in India Analogous .. | 126—128 |
| Inadequacy of Provincial Action .. | 128 |
| Need for Expert Agency—A National Investment Commission .. | 128, 129 |
| Balancing of Investment not the urgent problem .. | 129 |
| Need for Basic Legislation as first step .. | 129—131 |
| Constitutional Position .. | 131 |
| The Content of Initial Legislation—a brief view .. | 131 |
| Rule Making .. | 131, 132 |
| An Appeal to Constitution Makers .. | 131, 132 |

CHAPTER XI.

| | |
|--|----------|
| LINES OF REGULATION—PROPOSALS .. | 133—153 |
| No Rigid Control Recommended .. | 133 |
| Re-organisation a Pre-requisite .. | 133, 134 |
| Competing Stock Exchanges not to be allowed in the same City .. | 134—136 |
| Registration of Stock Exchanges, Curb Exchanges and Outside Brokers .. | 136 |

| | <i>Page</i> |
|---|-------------|
| Stock Exchange—Re-organisation | 136—139 |
| Compulsory Incorporation? | 136, 137 |
| Rules and Regulations | 137 |
| Should Members provide Security? | 137, 138 |
| Governing Board—Outside Representation | 138 |
| President | 138, 139 |
| Governing Board—Powers | 139, 140 |
| Forward Dealings and <i>Budla</i> | 140, 141 |
| Ready Delivery Contracts | 141, 142 |
| Listing Regulations | 142 |
| Compulsory Margins | 142—144 |
| Brokers and Jobbers | 144, 145 |
| Clearing Houses | 146 |
| Blank Transfers | 146, 147 |
| Over-the-Counter Market | 147 |
| Example of the U. K. | 147 |
| Control of Company Directors' and Promoters' malpractices | 147, 148 |
| Supply of Statistics | 149, 150 |
| Revenue—A Sales Tax on Security Transactions | 150, 151 |
| Conclusion | 151—153 |

CHAPTER XII.

| | |
|--|---------|
| SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS | 154—163 |
|--|---------|

ADDENDUM

Inside cover page

CHAPTER I

HISTORY AND PRESENT POSITION OF THE INDIAN SECURITY MARKET

A.—Historical Survey.

1. Beginnings of the Stock Market in India : Before 1914.

The organised security market in India is a comparatively recent development. In the year 1933, only three cities in India had Stock Exchanges (Bombay, Calcutta and Ahmedabad). There was some trade in securities, even in the 18th century, at any rate in Calcutta, and contemporary newspapers gave quotations of security prices. But, for long this trade was confined to Government paper and a few Bank shares. Although the Indian Companies Act has been in force since 1866, only after World War I did corporate enterprise become an important factor in Indian economy. In 1914-15, there were 2,545 joint stock companies in India with a total paid-up capital of Rs. 81 crores ; by 1939-40, the number of companies rose to 11,372 and the paid-up capital to Rs. 303.7 crores and in the latest year for which figures are available (1944-45) the number of companies was 14,859 and the total paid-up capital was Rs. 388.9 crores. (See Chapter III.)

2. After the Government of India came under the Crown in 1858, British capital and enterprise flowed freely into the country without the checks placed on them by the East India Company, and this resulted in the opening of tea and coffee plantations, jute mills and coal mines. When the American Civil War (1860-4) stopped cotton supplies to Lancashire, prices of Indian cotton went up to record heights, and this brought much money into the hands of Bombay cotton dealers and some of this flowed into the shares of the numerous joint stock companies which were floated in Bombay under the boom conditions which then prevailed. Many of these flotations were of an unstable character, but share dealings thus became popular and a 'speculative fever' was the result. The boom indeed burst in 1865, several companies failed and a severe depression followed. But the expansion of liquid capital had certain lasting results and a regular market in securities was one of them. In 1865, there were as many as 100 share brokers in Bombay, the chief of them being Seth Premchand Roychand.

Bombay Stock Exchange.

3. Benefiting by the experiences of the early sixties the stock and share dealers of Bombay began to organise themselves for the safety of themselves and the public. In 1875, a Brokers' Association with 300 members was organised with its office in Dalal Street. In 1877, the Native Stock and Share Brokers' Association (which has come to be called the "Bombay Stock Exchange") was founded "to support and protect the character and status of brokers and to further the interests of both Brokers and public dealing in Bombay in stocks, shares and like securities and in exchange, to promote honourable practices, to discourage and suppress malpractices," etc. This Association was formally constituted under an indenture dated 3rd December 1887, and had a membership of 361 in 1909. Seth Chunilal Motichand was its first President. Till 1914, however, dealings on the Exchange (apart from Government securities) were limited to a few textile shares, and the trade was not properly organised.

Calcutta Stock Exchange.

4. In Calcutta also the sixties witnessed a great fillip in economic activity. The number of tea and jute companies increased and dealings in their shares became important. In 1864, the daily market reports of Roussac & Co. gave quotations for as many as 91 joint stock companies, tea being the largest group with 38 concerns. For a long time dealings were carried on under a neem tree and were of an unorganised character. Finally, as a result of the combined efforts of European and Indian brokers under the leadership of Messrs. Place, Siddons & Gough, a private association called the Calcutta Stock Exchange Association was started in 1908, with a membership of 150, and it soon set up its office at what is now No. 2, Royal Exchange Place. The business of the Association soon expanded and it was subsequently (1923) incorporated as a joint stock company.

Ahmedabad Stock Exchange.

5. After 1880, Ahmedabad forged ahead with a growing textile industry under indigenous joint stock enterprise. The need for share dealings was felt there, and thus came into being, in 1894, the Ahmedabad Share & Stock Brokers' Association, which like the Native Stock & Share Brokers' Association of Bombay, is a registered but unincorporated non-profit association.

2. World War I and After.

6. World War I gave a great impetus to the growth of stock and share dealings. Before that War, dealings in Stock exchanges were mostly confined to Government securities. During the War, especially after the importation of manufactured articles from England became difficult, numerous new companies were floated and some of the war savings were invested in them. Owing to the high price of all articles, share values also rose to high levels and this attracted the cupidity of speculators and gamblers. Several corners arose, especially in textile mill shares. The rise in the value of a membership card of the Bombay Stock Exchange from Rs. 2,900 in 1914 to Rs. 48,000 in 1921 gives some indication of the boom in the stock market.

7. When share dealings grew under war-time boom conditions, a rival Stock Exchange was started in Bombay in 1917 and another in Ahmedabad in 1920 (Gujarat Share & Stock Exchange). In Madras, a stock exchange came into being in 1920, with 100 members on the rolls, for dealing chiefly in mill shares. But the boom conditions did not last long. The slump of 1921 was followed by a sharp fall in share prices and by many company failures. The rival stock exchange in Bombay had then to be closed down, and the new Madras Stock Exchange also became moribund owing to want of business.

Atlay Committee.

8. The stock market crash in Bombay that followed the slump roused considerable public criticism, the brunt of which fell on the authorities of the Bombay Stock Exchange. Public discontent was voiced in a resolution of the Bombay Legislative Council moved by Mr. Havelivalla, calling on Government to appoint a committee to enquire into the working of the Bombay Stock Exchange. As a result, a committee was appointed by the Bombay Government in 1923 to

enquire into the working of the Bombay Stock Exchange. Sir Wilfred Atlay (some time Chairman of the London Stock Exchange) was the Chairman of the Committee and Sir Fazalbhoy Currimbhoy, Sir Purushotamdas Thakurdas and Mr. Bhulabhai Desai, among others, were Members. The Report of the Committee disclosed much laxity in the administration of the Bombay Stock Exchange. Rules and Regulations were most difficult to ascertain; some were printed, some had never been printed nor published; and no one, whether member of the Association or the public, had any opportunity of ascertaining exactly what rules were in force. There was also evidence of supineness in enforcing rules and taking disciplinary measures against members of the Association. On the question of corners, which "had become a recognized phenomenon in the share market of Bombay," the Committee found that the existing rules of the Association on the subject were the fundamental cause of all the trouble, and recommended their deletion. The Committee was also convinced that for tackling corners, the short seller should, in the absence of fraud, be left to pay the penalty. The Association agreed to delete the rules in question but preferred to place instead the modified rules proposed in the Minority Report by Mr. Bhulabhai Desai which gave the Committee of the Association power to declare a corner in any share when it is convinced that there is going to be a corner, and to suspend all Future dealings in it for the then ensuing and the next following *vaida*. The Association also agreed to publish its rules and introduce new rules as suggested by the Committee.

Bombay Legislation.

9. While action by Government was under contemplation speculation again developed on a large scale in Bombay and this led to a crash in June 1925, and great panic in the stock exchange followed. This strengthened the hands of Government for taking action to control forward dealings. Government sought to assume authority to control the rule-making power of the Association, and in return to grant to it by charter a monopoly of organised trading in securities. But the Association did not accept the offer, and the wisdom of this refusal has since been seriously doubted.

10. Government, therefore, had no alternative but to enact legislation for safeguarding the interests of the public. Accordingly the Securities Contracts Control Act of 1925 was passed, by which all contracts on the exchange other than ready delivery contracts were to be void unless made subject to rules approved by Government. The Act came into operation in the city of Bombay on January 1, 1926. Soon afterwards, the Native Share & Stock Brokers' Association submitted a complete set of rules and regulations for the approval of Government and after some deliberation, the rules were sanctioned by Government on 14th May 1927. Rule 335 gave the Board of Directors of the Association power to intervene in case of emergencies like corners, crises, etc. No addition or alterations to or rescinding of the rules could be made without the approval of the Government. The powers of control thus assumed by Government were not, however, very effective as will be shown later.

11. The Wall Street crash of 1929 and the world economic crisis that followed had their repercussions on Indian stock exchanges, especially after the abandonment of gold standard by the U. K. in September 1931. The political turmoils in the years 1930-32 also had serious consequences on business activity. Matters came to a crisis in

1933 with the failure of Messrs. Currimbhoy Ebrahim & Sons Ltd. who were managing agents for certain textile companies. As a result, dealings on forward account were suspended for seven weeks (from 26th September to 11th November 1933).

A Period of Expansion.

12. From 1934 economic conditions began to improve. Prices again tended to move upward and speculative activity revived. Taking advantage of this improvement in business conditions, new stock exchanges were started in several cities. The Madras Stock Exchange was revived in 1937, with a growing trade largely in plantation and mill shares. The rapid increase in the number of textile companies in and around Coimbatore, and the floatations of many plantation ventures in South India gave strength to the revived stock exchange. In Lahore a new stock exchange was started in 1934 and with this later merged the Punjab Stock Exchange Ltd. incorporated in 1936. In 1939, the Ahmedabad Share & Stock Brokers' Association was recognised by the Government of Bombay under the Securities Contracts Control Act and its rules were remodelled on those of the Bombay Stock Exchange.

13. Rival stock exchanges also came to be set up in Calcutta and Bombay. In Calcutta, where the old Stock Exchange carried on only cash business, a section of public felt the need for forward dealings, and to meet this a new stock exchange (The Bengal Share and Stock Exchange Ltd.) was established in 1937, and this adopted forward trading in certain securities on the basis of monthly settlements. In Bombay too, a new stock exchange, limited by guarantee, under the title of the Indian Stock Exchange Ltd. was started in February 1938 with an influential Board of Directors, consisting of Sir Chunilal B. Mehta and others.

Morison Committee Enquiry.

14. The revival in stock exchange business after 1934 in Bombay brought to the test the efficacy of the Bombay Act of 1925. Speculators became as active as ever and there was a boom in share prices. But the boom soon burst (April 1935), and this was followed, in 1936, by a fresh crisis resulting from the manipulations of professional jobbers. Forward markets were then suspended. Thus, in spite of the Act of 1925, there were crises in the years 1928, 1930, 1933, 1935 and 1936. Public criticism therefore became noisy against the Bombay Stock Exchange, and against the Association which managed it. This led to a second enquiry early in 1937 by a Committee presided over by Mr. W. B. Morison, who too came from the London Stock Exchange. The recommendations of the Committee were carefully drawn up. Those fall into two groups, one requiring legislation and the other which could be implemented directly by the stock exchange under existing law. These latter recommendations were accepted by the stock exchange authorities, after considerable deliberation. A new set of rules, submitted by the Association for Government approval, were finally sanctioned on May 31, 1938.

15. The recommendations involving legislation were (i) the introduction of a compulsory system of margins, (ii) the abolition of blank transfers, (iii) the reservation by Government of power to impose rules on the Association, (iv) the abolition of the Association's over-riding power over the Board of Directors in certain circumstances and (v) extension of control over ready delivery contracts and the amendment

of the definition of "ready delivery contract." All these recommendations came under scrutiny and certain decisions were taken in 1938, the Congress Ministry had decided to introduce a bill for controlling forward dealings, but this did not materialize owing to the Ministry giving up office on the outbreak of War.

Crisis in Calcutta Market.

16. A reference must be made, at least in passing, to the crisis in the Calcutta stock market in 1937, following the tremendous boom in the Indian Iron & Steel Co.'s shares. The price of these shares, standing below par (Rs. 9½) in June 1936, shot up to Rs. 30 by January 1937 and further up to Rs. 79-12-0 on 6th April 1937. No dividend, let it be noted, had been till then paid by the company. About that time, it is true boom conditions prevailed also in New York and London; but the position at Calcutta went far beyond anything known before in the annals of that market. "For the first time in its history, the stock market became the playground for all comers. Seized with an insatiable lust for money-making, uninitiated in the technique of stock speculation, ill-informed as to the relative position of and the value of the various speculative shares, the man-in-the-street was wildly dragged into the maelstrom of stock market boom." After reaching the above record price on 6th April, Indian Irons fell abruptly to Rs. 43-4-0 by the end of the month, causing immense loss to numerous persons and benefiting only a few clever manipulators who had taken full advantage of the pitiable *laissez faire* policy then pursued by Government.

3. World War II and After (1940-46).

17. During the first years of World War II, fluctuations arose in the security market in India, but subsequently with the large increase of profits due to war orders, share prices also improved and a great many new stock exchanges and share bazaars had sprung up for meeting the new situation.

18. For a few months after the outbreak of war, share prices were on the up-grade, but with the fall of France in May 1940 stock exchanges received a rude shock and as a result, the Calcutta Stock Exchange remained closed for six weeks. On 14th June, forward trading was closed on the Bombay Stock Exchange and minimum prices were fixed for all shares; special rules for the settlement of transactions in a few specified shares were also formulated.

Minimum Prices for Government Securities Fixed.

19. Fresh surprises were in store during 1941. The entry of Japan into the war caused a serious crisis in the Calcutta Stock Exchange and this led to the fixing of minimum prices there for some of the speculative scrips. The initial successes of Japan and the menace this meant to the safety of India caused a sharp decline in the security and share prices, and various steps had to be taken for counteracting this. Institutional investors as well as Government were concerned about the depreciation in the price of Government securities, beyond a certain limit, and therefore on 2nd March 1942, a Gazette Extraordinary was issued prohibiting dealings in Government securities below fixed minimum prices. Attempts were also made by certain stock exchange authorities to fix minimum prices for certain industrial

scrips, but this was not quite successful in maintaining share prices. On October 15, 1942, forward trading was suspended indefinitely on the Bombay Stock Exchange. But the situation considerably improved in 1943 and this improvement was maintained till the end of war, inspite of various adverse factors.

Control of Forward Dealings.

20. In the meantime the increase of money in circulation without a corresponding increase in the quantity of goods resulted in price inflation which became serious after the entry of Japan into war, and as it was legitimately believed that speculation in commodity and share markets had much to do with the growing inflation, measures were urged for curbing it. Accordingly early in 1943, the Government of India took action by prohibiting forward trade in the commodity markets, cotton, oil seeds and bullion, but it was thought that this only diverted the attention of speculators to the share market. Although the Bombay stock market had been technically on a ready delivery basis for some time, it could not work without *vaida* business, and it is believed that forward dealings, in some form or other, were going on, under the guise of *budla*. To cope with such a situation, the Defence of India Rule 94C was promulgated on 24th September 1943. This Ordinance prohibited all dealings, other than 'ready delivery contracts,' and limited the period of such contracts to seven days. Stock exchanges were prohibited from "permitting or affording facilities" for *budla* transactions. Options were also banned. While the Ordinance ruled out forward contracts and *budla* on the floor of the stock exchange, there was nothing to prevent such contracts and *budla* taking place outside the floor and as there was no proper arrangement made for administering this Rule, such transactions went on without let or hindrance (according to some reports even on the floor of certain stock exchanges).

Growth of Outside Markets.

21. The one patent result of the Ordinance was the growth of share dealings outside the stock exchanges, in unorganised share bazaars (e.g., 'grey' market in Bombay and Ahmedabad, and 'Katni' market in Calcutta) free from restrictions imposed on stock exchanges by legislation or Ordinance. The business of these outside markets soon became much larger than in the organised stock exchanges. In Calcutta, the volume of transactions of the 'Katni' market (just outside the Calcutta Stock Exchange) was estimated in 1945 to have been as much as ten times that in the official Stock Exchange. Most of the business in these outside markets was pure gambling in differences, but it was not easy for any Government to detect it.

New Stock Exchanges.

22. In the meantime, numerous new stock exchanges had been started in cities and towns. In Ahmedabad, where owing to various causes speculative share dealings took deep root, the number of rival stock exchanges rose to 6 and in Lahore which witnessed a great expansion of monetary incomes during World War II, the number became 5. One of the new stock exchanges in Ahmedabad (the Indian Share and General Exchange Association) claimed that as the large sums of money in the hands of the public sought channels of invest-

ment, the need for a new stock exchange was felt. The claim of another in the same town (the Bombay Share and Stock Brokers' Association) was that as other stock exchanges in the city dealt in only local mills shares, a new concern was required for trading in outside scrips. Even more plausible reasons were urged by the new stock exchanges in Lahore. One of them, the Lahore Stock Exchange Ltd., stated in its memorandum that as there was, after Japan's entry into the war, a scare in the business circles in Bombay and Calcutta, the Punjab was felt a safer place for their business. The increase in the amounts of money seeking investment was also pointed out as another ground. New stock exchanges arose also in Cawnpore (the U. P. Stock Exchange Ltd.), Nagpur, Delhi and other centres. Thus, the number of stock exchanges increased from seven at the outbreak of war to about twenty-one in 1945. (This does not include the unregistered share bazaars and bucket shops which had sprung up in war time to do business which no stock exchange would admit). The number of exchanges has since fallen in one case by amalgamation (Delhi) and in other cases by ceasing to operate in stock dealings (two in Ahmedabad). The total number today is about 18 (excluding Indian States) ~~where two exchanges function, one in Hyderabad and another in Bangalore).~~

23. But this does not tell the whole story of the new stock exchanges. With the growth in number of the exchange divergences also increased between them regarding constitution, management, powers, rules of business, etc. Some are limited liability companies registered under the Indian Companies Act ; others are private associations, some registered and others unregistered. Even among the limited liability companies, some are private and others public. In respect also of the rules regulating the conduct of business, the various exchanges differ widely. Many of the older exchanges have fully written rules, while some of the newer ones work on unwritten rules and usages. The older exchanges confine themselves to trade in securities ; but the newly started ones, especially some in Ahmedabad and one in Lahore, permit also speculation in commodities (cotton, oil seeds, etc.) and bullion. Such interlocking of speculation in commodities with stock dealings obtained in Germany before 1896, but is not now permitted in any advanced country.

24. Side by side with the stock exchanges have also sprung up two competitors in the security trade, namely street markets and independent firms. About the large street markets in Calcutta and Bombay mention has already been made. Such share bazaars have also sprung up in other cities. Similarly independent firms have also been set up to carry on what is called over-the-counter trade. Some of these are proprietary firms, while others are incorporated under the Indian Companies Act. Besides engaging in stock and share business many of these firms speculate also in commodities and bullion, and some in addition do banking and managing agency business too. By clever publicity methods, they have drawn into their clutches many persons interested in making easy money. With large resources partly drawn as share capital or as deposits from the public, some of these firms have been able to carry on manipulations in commodity and share prices, and have become a menace to the organised security market. All these developments have been possible, because of the absence of any effective regulation by Government in this important field.

Post-war Developments : Lapse of the D.I.R.

25. Before closing this historical survey, we may briefly refer

here to important developments connected with the stock market after the termination of war. One of them is the lapse of D.I.R. 94C at the end of September 1946. The ban on forward trading was thus lifted and the exchanges were free to return to their pre-Ordinance modes of business. But in practice no serious change was involved by this, seeing that the D.I.R. was so extensively evaded even when it was in operation, as shown above.

Share Boom 1946—and Decline 1947.

26. The more important of the post-war developments is the boom in share prices, which starting in September 1945 grew into serious proportions towards the middle of 1946, largely owing to excessive optimism generated by various factors, chief among which were the flush of money in the hands of the investing public, the absence of alternative channels of investment, the rather premature abolition of the E.P.T., and not least, the policy of cheap money unaccompanied by any positive effort to have it used in productive channels. The crisis that followed was serious, especially in Calcutta where a large number of mushroom banks that had been making liberal advances on shares came to grief and had to close their doors. In Bombay too, heavy liquidation resulted. Then followed a sharp decline in share prices, aggravated largely by a deterioration in the communal situation and by political uncertainties generally. The Calcutta Stock Exchange fixed minimum prices for a certain number of speculative scrips, but this proved ineffective. Speculation in unofficial markets at Calcutta and unseemly bear selling in the Bombay market brought about almost a landslide in share prices in May 1947. It was thus made clear how weak stock exchanges can be when their members are out to get rich quick, at the cost of the investing public.

B. COMPOSITION OF THE INDIAN SECURITY MARKET.

27. It may be clear from the foregoing that the security market in India is now in a bewildering condition. In many of the leading cities of India there is a strange medley of stock exchanges, street bazaars and independent firms, all competing with one another for the trade in the same securities. In other countries too, notably in the U. S. A., outside markets are recognised, but they operate over a different field and do not directly compete with the stock exchanges. There are in many American cities one stock exchange for trade in securities which are listed under the rather exacting listing requirements of the exchange, one curb exchange which admits for trade securities not listed on the stock exchange, and a certain number of independent firms doing over-the-counter business, i.e. direct sale to or purchase from firms over the counter, in respect of certain securities which are traded neither on the stock exchange nor on the curb exchange. In India, on the other hand, in certain cities there are many competing stock exchanges, besides curb markets and many independent dealers. And all these are entitled to trade in the same securities and in addition some speculate also in bullion and commodities. Such uncontrolled developments have brought about inordinate speculation, and have given rise to injurious manipulations, as will be shown in Chapter IV.

28. The various components of the Indian security market may be classified as follows :—(I) Stock Exchanges ; (II) Street markets and share bazaars and (III) Independent Dealers.

I. STOCK EXCHANGES.

29. A distinction may be drawn between the two stock exchanges recognised by Government and others not so recognised, but a more reasonable basis of classification will be the nature of organisation of the stock exchanges.

30. The oldest of the Indian stock exchanges were organised as private non-profit associations. Subsequently when the Indian Companies Act (1913) came into force, incorporation came much into vogue, one of the private associations (the Calcutta Stock Exchange) got itself incorporated, and new exchanges were organised as joint stock companies. Thus of the 18 stock exchanges working now, 5 are private associations and 13 are joint stock companies. Stock exchanges in India may therefore be classified under two categories :—

(A) Private Associations, and

(B) Joint Stock Companies.

31. A. Private Associations.

(i) Registered Stock Exchange Associations recognised by Government.

(1) The Native Share and Stock Brokers' Association, Bombay. (Bombay Stock Exchange).

(2) Ahmedabad Share and Stock Brokers' Association, Ahmedabad. (Ahmedabad Stock Exchange).

(ii) Other Private Associations, some registered.

(1) Gujarat Share and Stock Exchange, Ahmedabad.

(2) Bombay Share & Stock Brokers' Association, Ahmedabad.

(3) Indian Share & General Exchange Association, Ahmedabad.

(It must be noted that although all the five above are private associations, the distinction between the two classes of Associations is fundamental, seeing that the former (A i) works under fully codified rules recognised by Government, while the latter (A ii) have only partially codified rules, and are not recognised by Government. The fact that some of the Private Associations under (A ii) are not registered is also important).

32. B. Limited Liability Companies.

Limited liability companies, some private companies and others public; most of them limited by share capital and one limited by guarantee. The great majority of the stock exchanges in India are of this category. These range from the Calcutta Stock Exchange Ltd., with 256 member firms, to small incipient concerns with hardly a dozen members. The following thirteen stock exchanges are of this category :—

1. The Calcutta Stock Exchange Ltd., Calcutta.
2. The Bengal Share & Stock Exchange Ltd., Calcutta.
3. The Stock Exchange Association of Bengal Ltd., Calcutta.
4. The Indian Stock Exchange Ltd., Bombay.
5. The Madras Stock Exchange Ltd., Madras.
6. The Punjab Stock Exchange, Ltd., Lahore.
7. The Punjab Stock & Share Brokers' Association Ltd., Lahore.
8. The Lahore Stock Exchange Ltd., Lahore.
9. The Lahore Central Stock Exchange Ltd., Lahore.
10. The All-India Stock Exchange Ltd., Lahore.
11. The Delhi Stock Exchange Ltd., Delhi.

12. The U. P. Stock Exchange Ltd., Cawnpore.
13. The Nagpur Stock Exchange Ltd., Nagpur.

II. Street Markets and Share Bazaars.

34. Some in cities with well established exchanges (Katni Market in Calcutta, Grey Market in Bombay), and others in small towns with no stock exchanges.

III. Independent Dealers.

35. Independent dealers engaged in over-the-counter trade ; some are incorporated, others private. Some of these deal in commodities and bullion as well, and in the case of some share dealings are only a side-line.

36. Some explanation may be apposite here regarding curbs or street markets and the independent dealers. The term 'Curb' has long been in use in the U. S. A. to denote stock markets in the open street. One of the earliest of these curbs is that of New York which met for long in Broad Street, and worked with little or no organisation. The brokers met in the middle of the street and the trades were communicated to their offices by agents who looked on at the scene from the windows of building on each side. Owing to the public outcry against frauds long practised on the Curb, an enquiry was made early in the present century, and as a result the New York Curb Association was organised with fixed rules and membership. In 1921, the Curb moved into a five-story building and soon became a well-organised exchange, second only to the New York Stock Exchange in the U. S. A. in volume of business. It has a separate list of securities, mostly connected with oil and mining. Generally new and unseasoned securities and securities which cannot comply with stricter listing requirements of the New York Exchange come to be listed at the Curb. Thereby this market has become " the great crucible in which are tested the thousand and one hasty stock floatations of each new era of expansion in the country." In New York the stock exchange and the curb exchange work on a complementary basis, as mentioned above. But in India, the Curbs are still in an unregenerate condition, serving as a serious obstacle to orderly stock and share trade in the organised stock market.

37. The " Independent Dealers " mentioned as the third division of the Indian stock market corresponds to the over-the-counter market of the U. S. A. Here again, the difference is great seeing that while independent firms in those countries have been brought under strict regulation like the stock exchanges and operate in a field marked out for them, similar firms in India are entirely unregulated and unequal competition has been taking place, with injurious consequences (as will be shown in chapter VI) between these unregulated firms and the regulated market.

C. A Survey of the Security Market.

38. We will now make a rapid survey of the security markets in different parts of India so as to give some idea of their general position.

39. Bombay and Calcutta are naturally the largest centres of the Indian security market and are responsible for the great bulk of the stock dealings in the country. Bombay began chiefly as a market for textile shares, but it is today a national market, with issues of many kinds and from various parts of India in its trading list. Two Stock Exchanges now function in Bombay, and there is also an active curb, the 'Grey Market.' The Native Share & Stock Brokers' Association,

(the "Bombay Stock Exchange") still occupies a premier position in the country and has the largest membership (about 500 members). It is a voluntary non-profit registered association of stock-brokers. It has a large forward market, besides cash dealings. This exchange has had the guidance of shrewd businessmen from its inception and Mr. K. R. P. Shroff has been its President since 1923. The Indian Stock Exchange, which began to function in 1938, is a limited liability company, and Sir Chunilal B. Mehta has been its chief leader. This Exchange also deals in nearly the same securities as the Bombay Stock Exchange.

40. In Calcutta there are three stock exchanges. The largest of them, the Calcutta Stock Exchange, is a national market, it has long been specializing in jute, coal, tea and mining shares. On its trading list are as many as 864 issues of 629 companies. This exchange is composed of 256 firms consisting of 980 persons. It is a limited liability company, controlled by its Board of Directors. The trade on the exchange is on a cash, or ready delivery basis, and dealings are permitted only securities listed under its regulations. Two other stock exchanges have lately come into being in Calcutta. Of these, the Bengal Share and Stock Exchange, Ltd., provides a forward market as well as a cash market in the same securities listed in the Calcutta Stock Exchange. The business on it was suspended in war time owing to the prohibition of forward dealings. The other concern, the Stock Exchange Association of Bengal, Ltd., is largely modelled on the Calcutta Stock Exchange, except that it has no listing regulations and allows term-business (which is something like forward business).

41. Over and above these three rival stock exchanges, there is also at Calcutta a large street market called 'Katni' working just outside the Calcutta Stock Exchange, carrying on dealings in the same scrips and exerting a powerful influence on the organised security market itself. The volume of transactions in this market can be seen from the fact that the unit of business in the Katni is 1,000 shares, when it is 100 on organised stock exchanges. But the shares traded in are neither delivered nor paid for, and therefore it is practically a gambling market. Although it is thus a serious menace to the Calcutta Stock Exchange, many members of this Exchange are working in the Katni too. Regular membership is said to number about 300. There are also rules and regulations, membership fees, etc.

42. Independent broking firms in Calcutta are more numerous and powerful. Although they are independent of the organised stock market, they influence it in many ways as will be shown elsewhere. The National Share Exchange, Ltd., Bengal Share Dealers' Syndicate Ltd., and Share Exchange Corporation Ltd., are some of the leading firms of this category. Several of these firms are registered under the Indian Companies Act, but many others are partnerships or proprietary firms. Some of them have raised large funds by receiving deposits from the public. With such funds, they deal in shares extensively whether as brokers, dealers or as both. Some of them function also as issue houses and underwriting firms, and have a large hand in stagging operations. It is through such agencies that unscrupulous company promoters and managing agents push doubtful securities on the market, often in collusion with stock exchange members. Such firms also take an active hand in manipulating share prices. In some ways, they are a larger menace to the organised security market than street markets and share bazaars.

43. The Madras Stock Exchange provides for trade chiefly in plantation and local textile shares, but there is a large trade in various

inter-market counters also in Madras. There are no rival stock exchanges there, nor unorganised share bazaars as in Calcutta and Bombay.

44. In Ahmedabad, six rival stock exchanges worked side by side in 1945, but two of them have since disappeared. Only the recognised stock exchanges, namely the Ahmedabad Share Brokers' Association has got proper rules and has strict listing requirements. The only other two exchanges worth noting are the Gujarat Share & Stock Exchange, which was started in 1920 and the Bombay Share & Stock Brokers' Association, which came into being in 1943. Both have enrolled several hundreds of members including a few lawyers, bankers and accountants, but active members are few, and the total business not considerable. The other concerns do not confine themselves to trade in securities, but also permit speculation in bullion and commodities.

45. Lahore has five rival stock exchanges working side by side trading in the same securities and competing with one another. Unlike exchanges in Ahmedabad, they are all registered under the Indian Companies Act. Three of them are concerned exclusively with stock dealings whilst the other two are reported to permit multiple trade as in the case of the Ahmedabad exchanges mentioned above.

46. In Delhi two Stock Exchanges were started in war-time, but they are under amalgamation. In Cawnpore and Nagpur there is only one stock exchange each, although there are independent firms competing in the share trade. These are all companies limited by share capital. While in Delhi and Nagpur, the market confines itself to cash or ready delivery business, the U. P. Stock Exchange Ltd., Cawnpore carries on both cash and forward business. Cawnpore specialises in sugar shares. Neither in Lahore nor in the cities just mentioned are any listing requirements insisted on by stock exchange authorities. The admission of scrips is left to the discretion of the managing committee.

47. In several towns, not large enough to have regular stock exchanges, there are unorganised share bazaars, and brokers and dealers there operate in them. Such share bazaars are found at Karachi, Poona, Ahmedabad, Madura, Coimbatore and Karaikudi.

48. Among Indian States, Hyderabad and Mysore can claim to have made a beginning in this line. The Hyderabad Stock Exchange, started in 1944, is an incorporated association limited by guarantee; it is regulated by the Hyderabad Securities Contracts Control Act. ~~A small stock exchange has also sprung up in Bangalore City.~~

49. It may be clear from the above account that the security market in India is in a parlous state. In not less than four cities rival stock exchanges are working side by side and in addition there are also street markets and independent firms dealing in the same securities as stock exchanges. In other countries such a state of things will not be tolerated as there are laws regulating the stock market and competent authorities to administer them. But in India, a *laissez faire* policy has been pursued by Government for long. Only in one Province has some legislation been carried out for regulating the trade in securities, as we have seen, and even this is of very limited scope.

CHAPTER II.

CONSTITUTION AND MANAGEMENT OF STOCK EXCHANGES.

As shown in Chapter I, the stock exchanges in India fall into two groups—(A) Private Associations two of them recognised by Provincial Government (Bombay); (B) limited liability companies.

2. It is proposed to make in this chapter a brief survey of the salient features of the constitution and administration of the various stock exchanges. A more detailed account regarding two important stock exchanges, one from group A and one from group B, are given in an appendix.

CONSTITUTION.

Private Associations.

3. Like the New York Stock Exchange, the two recognised stock exchanges, i.e., the Native Share & Stock Brokers' Association ("the Bombay Stock Exchange") and Ahmedabad Share & Stock Brokers' Association ("the Ahmedabad Stock Exchange") are unincorporated but registered non-profit associations. They are governed and regulated by their deeds of association and rules and bye-laws approved by the Bombay Government, under the Securities Contracts Control Act, 1925. Their constitution, rules and bye-laws are similar.

4. For the membership of these stock exchanges, there is no share qualification required. Membership of the Bombay Stock Exchange can either be acquired by the purchase of a card or be inherited by the legal heir of a deceased member. Application for membership should be recommended by two members of five years' standing. Election is by ballot and is required to be carried by three-fourths of the members of the governing board present. Membership is open only to natives of India and British subjects of Bombay Province. A candidate for membership has to satisfy the Board regarding his character, status and financial stability. New Members have to deposit a sum of Rs. 20,000 in cash or in approved securities, but this is returned if the member does not engage himself in forward business. A person is not eligible for membership if he is engaged either as member or as employee, in any business other than a stock and share broker, a general financial broker or a bullion and exchange broker. This restriction however does not apply to persons who were enrolled members before 1926, but applies to their successors who seek membership. Similarly members are prohibited from being member or subscriber or shareholder or even debenture holder of any other association where dealings in share and securities are carried on. Such restrictions, it is believed, led to the foundation of the Indian Stock Exchange Limited, Bombay. As the membership rules of the Ahmedabad Stock Exchange are the same as those of the Bombay Stock Exchange, they need not be dealt with here separately.

5. The London Stock Exchange is also a voluntary, unincorporated association. It is not incorporated in any form—by charter, by Act of Parliament or under the Companies Act. But it was from the beginning under a dual control—that of the proprietors or shareholders, represented by a body of nine Trustees and Managers, and the

members represented by the Committee for General Purposes. The former maintain the Exchange building and equipment and fix and collect the fees and subscriptions. The latter is in charge of the regulation of business, the enforcement of rules and the admission of securities. This 'dual control,' of which there has been much controversy, has lately (1945) been modified, with a view to greater co-ordination of work. Another difference between the Bombay and London exchanges is that the latter has a share qualification for membership. The present capital of the company is £720,000 represented by 20,000 shares on which £36 is credited as paid-up. The shares are quoted in the Stock Exchange Official List. Every member has to hold at least one share but no member can hold more than 200 shares. The present membership of the London Stock Exchange is roughly 4,000.

Company Exchanges.

Constitution.—6. Stock Exchanges in this group being joint stock companies, their power to make rules and regulations are derived from the memorandum and the articles of association of the company. Even in the one Province (Bombay) where there is a special statute empowering the recognition and regulation of stock exchanges, none of the exchanges in this group has been recognised or brought under regulation. The management and regulation of these exchanges is completely vested in the directorate of the company. Most of the exchanges are public limited companies, while a few are private limited. In regard to the limitation of liability, it may be stated that the liability of members of all the exchanges except one is limited by share capital. The one exception is the Indian Stock Exchange in Bombay, in the case of which the liability is limited by guarantee, i.e., a member is answerable to a liability only equivalent to the guarantee which he has undertaken.

7. Share qualification for membership is a fundamental feature of this group of exchanges. But the stock exchange companies stand in a different position, in many ways, from other limited liability companies. In the first place, their shares are not freely marketed nor marketable, unlike other company shares which are the very objects of the trade in exchanges. There are also restrictions regarding the number of shares which could be held by a member. In the case of most exchanges no member is allowed to have more than one share. The transfer of that share is restricted to persons having special qualifications. The transferee has to satisfy the directorate that he possesses all the qualifications prescribed for members.

8. Another important difference between ordinary joint stock companies and stock exchange companies is that while the liability of a shareholder in the former is limited to the full value of the share, the liability of the stock exchange company shareholder goes further; he will have to make further payments which may be decided by the Directorate of the company from time to time. Therefore though it is by virtue of membership, the liability is an unknown and variable one. In this respect, the position of the stock exchange shareholder is rather anomalous, and contravenes the very principle of incorporation, and of limited liability. Even if the transferee agrees to such terms, it is left to the absolute discretion of the company's directorate to enrol him as a shareholder.

9. There are also other peculiar features attaching to the stock exchange company shares. In the first place, despite their abnormal

prices, shares are not treated as an asset of the shareholder in respect of his creditors whether outside or inside the company. Secondly, a stock exchange company share is compulsorily forfeited to the company, by a decision of the directorate to that effect, for default or non-fulfilment of obligations arising out of stock exchange transactions between members. Thirdly shares may also be forfeited for the breach of rules and bye-laws of the stock exchange. Although such powers of forfeiture of share capital have been claimed and exercised by the stock exchange companies, its legal validity is still doubtful. Law suits involving this point are pending before the Calcutta High Court, against the Calcutta Stock Exchange. Serious repercussions may be expected on the Indian Security Market, if these law suits are decided against the stock exchange concerned.

These above features have a vital bearing on the constitution and membership of the stock exchanges of this group.

Membership Rules.

10. As regards the enrolment of members, the main principles adopted by the company stock exchanges are more or less similar. Every exchange being an incorporated company, registered holding of one of its shares is a necessary qualification and condition for membership. An important feature in the acquisition of a stock exchange share may be noted here, as there is some difference between these companies and other public limited companies. Stock Exchange Companies do not generally issue fully their authorised number of shares of different kinds at their respective face values. They generally issue shares at their face value only to those members who had joined as members of the Association prior to its incorporation and registration : in other words only to its founders. The remaining shares are kept in reserve to be sold very sparingly in future at the discretion of the Directorate, and at a higher price than the face value. It has been the practice of these exchanges to sell such reserved shares subsequently by calling for secret tenders. The result has been an abnormal and absurd inflation of the prices of these shares. For example, the Calcutta Stock Exchange has not issued any share in recent times for any price below Rs. 32,000, although its face value is only Rs. 1,000. It is also reported that at present a share is not available for any price less than Rs. 1,00,000. (This rigidity in the enrolment of members seems to have been one of the causes provoking others to start rival exchanges in a town.) Thus, the face value of a share has no significance or bearing on the admission of a candidate to membership ; the share is only similar to an admission card of the exchanges under A group, which has also gone up in value. (The membership card of the Bombay Stock Exchange was sold at Rs. 48,000 in 1920, and although it fell subsequently and had remained about Rs. 20,000 for long, it has again risen and is round about Rs. 40,000).

11. Besides the share qualification, there are certain additional requirements for membership and these along with the mode of enrolment vary among the exchanges. On the Calcutta Stock Exchange and the Madras Stock Exchange, there are two classes of members, namely the Founder Members and the Ordinary Members. The Founder Members of the Calcutta Stock Exchange were the members of the original unincorporated Association whose properties the present company had taken up at its inception. In lieu of surrendering their assets in the old exchange they were given shares without further payment, one to each whether individual or firm, to become automati-

cally the members of the new exchange. They were also exempted from the payment of the entrance fee; but they are to pay like the ordinary members the annual subscription and the other payments fixed by the Directorate from time to time.

12. In regard to the enrolment of ordinary members, the procedure, conditions and requirements are different. Any one who desires to become an ordinary member is to be elected by the committee on the recommendation of two members of the Association. On enquiry if the committee is satisfied as to his conduct, financial status, and other conditions he may be elected. An elected candidate is to acquire a share either from an existing holder or from the company directly if available and get it registered in his name. Unlike Founder Members, he is required to pay an entrance fee of Rs. 5,000 and the other subscriptions fixed by the Directorate from time to time. Nomination of membership is allowed in favour of a legal heir and in the case of joint Hindu family in favour of any member of the family.

13. The position of membership on Madras Stock Exchange is different. There, the two classes of shares, i.e., Founder shares and Ordinary shares are of different values, privileges and legal incidence in their relation to the respective memberships. The stock exchange company is authorised by virtue of its memorandum of association to issue 12 Founder Shares of Rs. 500 each and 38 Ordinary Shares of Rs. 1,000 each. But neither the ordinary shares nor even the Founder shares have been completely issued. A share of either class, therefore, may be available to anyone seeking membership. Thus, several years after the establishment of the institution one can become a founder member of the Madras Stock Exchange. As in Calcutta, an applicant for membership is to be elected by the Council of Management. But no applicant to a founder membership can be elected unless all the existing Founder Members have given their unanimous consent prior to such election. An application for ordinary membership is only to be passed by a majority of two-thirds of the members of the Council of Management. The elected candidate is to procure a share either from the company or from an existing holder and get it registered in his name. He is also to deposit a cash security of Rs. 10,000 with the company in addition to the payment of the usual subscriptions fixed by the Committee from time to time. If a member dies without nominating his successor, his legal heir is permitted to nominate either himself or any member of his family. Nomination by a member firm whether partnership or company is also allowed in favour of any other firm purchasing the rights of the former.

14. All the other exchanges too in the group, with the exception of the Indian Stock Exchange, have their respective share-capitals divided into a definite number of shares. But they have only one class of shares and as such only one class of members. Here also, every company has been found to have issued shares at their face value only to a few members who were there at the inception of the company. Their practice in further issue is to sell the shares sparingly either by calling tenders or at a price fixed by the Directorate from time to time in their discretion. Their principles and method of enrolment of members are similar to that of the Stock Exchange of Calcutta. In the U. P. Stock Exchange, in addition to the holding of a share and payment of an entrance fee (Rs. 250-500), a member is required to deposit a cash security of Rs. 5,000.

15. The position of membership in the Indian Stock Exchange is different from that of any other stock exchange in British India. This company has no share capital and its liability is limited only by

guarantee ; and members are only to undertake to pay Rs. 100 towards loss, if any in the event of winding up. Any one seeking membership, therefore, has no share value to pay ; but he is required to pay an entrance fee of Rs. 5,000 and a cash security of an equal amount. The procedure in the election to a membership is also somewhat different. A candidate seeking membership is only to apply to the Directorate with the entrance fees and the Directorate can admit or reject him in their discretion without any reference to the Association.

16. Unlike the exchanges under A group, no exchange in this group with the exception of two, namely the Calcutta Stock Exchange and the U. P. Stock Exchange, Cawnpore, prohibits its members from engaging in any other profession along with the membership of the exchange. Members of Calcutta Stock Exchange and the U. P. Stock Exchange are strictly forbidden from engaging whether as principal or employee in any other profession other than stock-broking. But members of every exchange are forbidden from becoming members of any other rival exchange in the same town ; they are prohibited even from doing any trade in stocks and shares with the members of the latter.

Membership in Practice.

17. Although various restrictions, financial and other, have been imposed on membership as shown above, it cannot be said that these restrictions have led to reasonable standards being maintained. Members of Stock Exchanges have heavy responsibilities. As advisers of the clients they have to study carefully the changing conditions of the various companies and public bodies whose issues are traded in on the exchange. Especially in these days of complex economic and political developments, not only business training and experience, but a certain minimum standard of education and training must be considered essential for membership. But the rules of even our leading stock exchanges do not insist on such qualifications, and any moneyed man can become a member by purchasing a card or share. Many also inherit membership, but there is no assurance that ability is also inherited. There are indeed member-firms in Bombay and Calcutta which can hold their own with similar firms in London or New York, but a large number are not competent for the profession and some are even illiterate.

18. In order to give competent advice to their clients, many member-firms in London and New York, maintain expert staffs for collecting full data regarding the condition of the various companies whose issues are traded in on the exchange. The position of the member-firms in India in this respect is (with few exceptions) deplorable.

19. There is provision on many stock exchanges for the appointment of clerks and member-assistants. They transact business as the agents of members on the floor of the exchange. On the London Stock Exchange, authorised clerks are given opportunities to obtain training and a certain number of memberships are reserved for them ; certain concessions are also given to them. Such facilities are not provided to this class of people on Indian stock exchanges, and their emoluments being low they are tempted to supplement their earnings by carrying on speculative dealings on their own accounts, and this has led to harmful consequences.

Partnerships.

20. Members can form partnerships. In Bombay permission to deal as a partnership must be obtained in writing from the Governing Board. A member can also enter into partnership with his son or sons, but the latter must be otherwise eligible for membership in all respects. Not only are members prohibited from entering into partnership with non-members, but even borrowing of money or scrips from non-members on certain terms is prohibited. On the Calcutta Stock Exchange, although members are not required to register their partnership firm, they have to obtain permission for the partner to use the rooms of the Exchange by paying an entrance fee.

Brokers and Jobbers.

21. On the London Stock Exchange, as is well known, the members are divided into two classes—Brokers and Jobbers. Each year members have to declare to which class they propose to belong. The jobber is essentially a dealer and is not allowed to deal directly with the public. The broker acts as an agent between the public and the jobber and works for a commission. The broker may match orders, but even for this he must put them through the books of the jobber and pay a small fee for the service. The jobber is thus a professional speculator, and generally specialises in a limited number of securities. Such a division between broker and jobber solves the inevitable conflict of interests which would arise if the broker who is an agent of the customer is also the dealer and thus acts as a principal to him (customer). The enormous number of issues traded in the London market also makes the jobber system there a necessity.

22. On the New York Stock Exchange, such a clear cut division between brokers and jobbers does not exist. There are commission brokers, two-dollar brokers, specialists, odd-lot dealers and floor traders. The two latter may be compared to the London jobbers; but the jobber in London occupies a much more important place than the odd-lot dealer and floor trader in New York. In the elaborate scheme of stock market reform recommended by the Twentieth Century Fund Inc. in 1934, a similar division as in London was proposed for New York. But this recommendation was not accepted on the ground that it would seriously disrupt the financial machinery of the country. It is also thought by some (e.g. Van Antwerp) that the New York practice of "a host of jobbers actively bidding and offering by gesture, and without collusion and each thereby contributing to the making of the freest possible market and the closest possible price" is superior to the London system ("The Stock Exchange from within" 1914).

23. On Indian stock exchanges, it has been found difficult to classify members as brokers and jobbers. Members of Indian stock exchanges are allowed to work both as broker and dealer. This has led to abuses and ways can perhaps be found as will be explained later for preventing such abuses without going the length of adopting the clear-cut separation between brokers and jobbers.

Taravanivalas.

24. There is, however, something like an ^{an} official division of members on the Bombay Stock Exchange between commission brokers and taravanivalas. But this division is not at all rigid and nothing binds a broker from dealing at the same time on his own account. The

taravanivala deals on his own account and not on behalf of clients. Like the specialists of New York, the taravanivalas generally specialise in one or two securities and carry on buying and selling at a particular cost. However, the resemblance between them and the jobbers of London is more formal than real. The difference has been well brought out by Mr. A. D. Shroff, who worked for twelve years on the Bombay Stock Exchange: "Their (taravanivala's) business is entirely of a parasitic nature—they rush in to buy or sell according as they find bonafide brokers trying to execute buying or selling orders. Their operations necessarily result in price movements almost always to the detriment of clients buying or selling. The London jobber is paid his 'turn' for the service he renders in making a price for a reasonable lot of the stocks he deals in. But in our market the parasite of a taravanivala is always an unnecessary obstruction to the fair execution of the clientele business and often a toll gather of a size in commensurate with the risks he runs. Besides, as all the operations of these dealers are essential for a settlement of difference with absolutely no intention to pay for a single share purchased or deliver a single share sold. The size of their operations has no reference to the value of the stock sold or purchased and consequently the operations are limited only by the avidity of the dealer." The Morison Committee made some recommendations for checking the taravanivalas' manipulating methods, and these were embodied in the stock exchange rules, but this reform does not seem to have produced the expected results.

25. Various attempts were made in Bombay to make a water-tight division between brokers and jobbers. In 1935 the President of the Bombay Stock Exchange wrote in the course of a communication to the Times of India: "If persons of sound financial standing would come forward to work as jobbers on the Bombay market in the same way as they work in London, I would be prepared to recommend to my association to admit them to the trading ring, even if they do not buy a card which is valued at Rs. 20,000 today." It is not known that any people availed themselves of this sporting offer.

Remisiers.

26. Another serious abuse on the Bombay Stock Exchange is connected with "Remisiers" (runners) employed by brokers to canvass business in return for half the brokerage commission. (Hence the term "half-commission men." They have also been called 'touts'). They are not allowed to sign contracts in their own name or even on behalf of their employers. They are also prohibited from dealing on the floor on behalf of their employers. Nevertheless these remisiers have drawn many unwary persons into the whirlwind of speculation and thus have brought the stock market into disrepute. The authorities of the Bombay exchange have indeed tried to place restrictions on remisiers. The Morison Committee recommended that the Remisiers must be compelled to make a deposit of Rs. 5,000 with the Association authorities as a guarantee of good faith, to pay an annual subscription to the Association and to sever their connection with any other business. The Governing Board of the Bombay Stock Exchange agreed to insist on the deposit from remisiers, but could not agree to levying a subscription from them in all cases.

ADMINISTRATION.

Governing Boards.

27. The management of the stock exchanges is vested in a governing body called 'Governing Board' in the Bombay Stock Exchange,

'Committee' in Calcutta Stock Exchange and 'Council of Management' in certain other places. This body is generally elected once a year out of the members of the general body. The Governing Board of the Bombay Stock Exchange consists of 16 members, elected by ballot every year. The Board elects a President, Vice-President and an Honorary Treasurer. The Board meets once a week usually. The Committee of the Calcutta Stock Exchange also consists of 16 members of whom 4 are to be Europeans, 4 Marwaris, 4 Bengalis and 4 of other Indian communities. Two members of each community retire every year. The Committee elects its own President. In Madras, the governing body is called the "Council of Management." Founder members form the majority on this Council. The Council elects a President, 2 Vice-Presidents, not more than 2 Secretaries and 2 Treasurers.

28. The constitution of the Governing Board of the Hyderabad Stock Exchange shows special features. The Board consists of 10 members of whom three are nominated by Government, one member is elected by Sahukaran Committee, one member is nominated by the Hyderabad State Bank, one member elected by the Hyderabad Chamber of Commerce, one member nominated by the Nizam's Government to represent the investing public and only three members elected from among the members in the Exchange. While the general management of the Council is vested in this Board, the day-to-day working of the Exchange is controlled by a Working Committee of the Board consisting of 4 members, one of whom is nominated by Government from among the nominees on the Board.

Management of the Company Exchanges.

29. Complicated problems have arisen in connection with the management of the company stock exchanges. The chief source of the complication is that the Managing Board of the Stock Exchange is the same as the Directorate of the Company. In other words, the body that manages the affairs of the Company is also responsible for making the rules and bye-laws of the exchange. Various anomalies and incongruities have arisen out of this, but it is not necessary to dilate here on these legal problems. It may be stated, however, that the organisation of stock exchanges as companies under the Indian Companies Act has not been altogether happy, that before things get worse the whole question must be examined from the economic as well as the legal point of view.

Committees.

30. On the New York and London stock exchanges, there are numerous sub-committees for looking after the day-to-day activities of the exchange. In the Indian stock exchanges also this procedure is adopted, although to a limited extent. In the Bombay Stock Exchange there are three committees, one for Arbitration, another regarding Defaulters and one for Listing arrangements. These committees are elected and appointed by the general body. The Arbitration Committee is composed of sixteen members, elected at a general body meeting. All claims and disputes between members arising out of transactions done under the rules are reported to this committee. Thereupon, adjudicators are appointed. The award of the Governing Board is final and binding. Members who do not abide by the judgment may be expelled by the Exchange. The Defaulters' Committee,

consisting of 6 members goes into the cases against defaulters, i.e., those unable to fulfil obligations arising out of the Stock Exchange transactions to a member or non-member. This is an important part of the work of an exchange, as will be seen from Chapter III.

31. The eight sub-committees of the Calcutta Stock Exchange are elected not from the General Body, (as in Bombay) but by the Committee of Management (Governing Board) from among themselves. Therefore, while the committees of the Bombay Stock Exchange are the authorized agents of the Association, the sub-committees of Calcutta are only the delegated agents of the Board of Directors of the Company. The largest of these sub-committees, dealing with complaints, has a membership of twelve. There are also sub-committees for Share Examination, Finance, Quotations, etc. These sub-committees are executive bodies and carry on their work independently. But appellate jurisdiction of their decision is vested in the General Committee. There is no Defaulters' Committee on the Calcutta Stock Exchange.

RULES AND REGULATIONS.

32. In the interests of the public as well as those of members, it is important that stock exchanges should regulate their conduct of business under proper rules and regulations. Most of the organised stock exchanges have written and codified rules and regulations for the conduct of business, but some of them, especially private associations are found to be rather lax in this matter.

33. In the case of the two recognised exchanges, namely, the Bombay Stock Exchange and the Ahmedabad Stock Exchange, rules and regulations have to be approved by the Bombay Government under the Act of 1925. Their Governing Boards have no power to rescind or add to the rules without the sanction of Government. Besides, the rules have to be published in Government Gazette, one month before they come into force for the knowledge of the public.

34. As regards the company exchanges, most of them have their written rules and regulations, although not complete in many cases. The Companies Act is concerned only with the working and management of the company and does not regulate the business between members, and between members and the public. The managing committee of these exchanges, constituted solely of members, have complete power to make, add to, or rescind any rule which regulates and controls the business between members and their relation to the public. But in the case of some of the exchanges of this group, e.g. the Lahore Central Stock Exchange and the Bengal Share and Stock Exchange, rules and regulations, it would appear, are only partly written. Thus their position in this respect is somewhat similar to that of the Bombay Stock Exchange prior to the Atlay Committee enquiry.

35. Much worse is the condition of the stock exchanges under the C group (private associations). Most of them work without written rules, and the position of those who deal with their members is not enviable.

36. As for the outside markets (Katni), there are no written rules, regulating their conduct of business. Trade is conducted according to certain conventions and usages. Their managing committees are neither legally competent nor armed with powers to enforce the agreement for transactions between brokers. The integrity among the latter and the fear of black-listing by fellow brokers are the only factors to ensure the fulfilment of transactions.

37. Thus as regards the rules regulating the conduct of trade we see the exchanges and other markets falling into four different groups, as under :—

- (1) Exchanges with well-defined and fully written rules, approved by a Provincial Government and published in the Government Gazette for the knowledge of the public.
- (2) Exchanges with well-defined and written rules drawn up by the Directorate of joint stock companies which maintain them.
- (3) Exchanges with rules partly written and partly unwritten.
- (4) Outside markets working under conventions and usages.

Listing Regulations.

38. A security is said to be "listed" when it is placed on the list of securities in which trading on a particular exchange is permitted. No stock exchange stands sponsor to every security thus listed there. No such thing is possible nor desirable. Although an exchange cannot give a guarantee regarding a listed stock, yet listing is of great advantage to the investor as well as to the company whose stock is thus listed. To the investor, listing gives a reasonable ground to believe that the issue of securities was legal, that the concern was legally organised and at the time of listing was a solvent going concern ; secondly, it is an assurance that at any time he can get full and recent information regarding the security from any member of the exchange ; and thirdly, it gives a higher collateral value to securities. To the issuing company also, listing of its stock is of great advantage, as thereby it will have a higher standing among investors and command a higher price. Nevertheless, in the U.S.A., for instance, many companies do not seek listing, either because they do not like to make the required reports regarding their affairs or because they do not want their securities subjected to the uncertainties of speculation.

39. In India listing regulations are strict on the recognised exchanges of Bombay and Ahmedabad, but much less so on the company exchanges. The unorganised exchanges of the C group do not insist on any listing requirements, and even many of the company exchanges (B group) are more or less in the same condition. Admission of scrips to trading is left to the discretion of the governing board.

40. On the Bombay Stock Exchange, trading is permitted only in the case of securities admitted after the rigorous test provided by the detailed listing regulations. The same is true also of the Ahmedabad Stock Exchange. There are two lists on these stock exchanges, one list of securities on which only cash dealings are permitted and another in which both cash and forward dealings are permitted (Sch. III). In the case of the latter list, the stock exchange has to be particularly strict (see appendix on Bombay Stock Exchange). The listing regulations of Bombay and Ahmedabad are modelled somewhat on those of the London Stock Exchange.

41. The listing regulations of the Calcutta Stock Exchange are much less exacting. Hence the long list of securities on this exchange containing some of which would not have been admitted, had there been strict listing rules. This is partly due to this stock exchange not permitting forward business ; perhaps the example of New York has also influenced Calcutta in this matter. But it must be noted that in the U.S.A. there is, in addition to company law (Securities Act), a system of registration of securities by the Securities Exchange Com-

mission essential for all securities to be listed on the national security exchanges, and this involves a thorough scrutiny.

42. In Bombay, the Listing Committee is appointed by the Governing Board and is constituted of four members selected from among the members of the Board themselves. But at Calcutta there is no separate Listing Committee, this work being done by the Governing Board itself.

NUMBER OF MEMBERS OF STOCK EXCHANGES.

BOMBAY

- | | |
|--|-----|
| 1. Native Share & Stock Brokers' Association | 500 |
| 2. The Indian Stock Exchange Ltd. | 302 |

CALCUTTA

- | | |
|-------------------------------------|-----|
| Calcutta Stock Exchange Association | 256 |
|-------------------------------------|-----|

AHMEDABAD

- | | |
|---|------|
| 1. Ahmedabad Share & Stock Brokers' Association | 425 |
| 2. Gujarat Share & Stock Exchange | 487* |
| 3. Bombay Share & Stock Brokers' Association | 767* |

MADRAS

- | | |
|--|----|
| The Madras Stock Exchange Association Ltd. | 20 |
|--|----|

PUNJAB

- | | |
|---|----|
| 1. The Stock & Share Brokers' Association, Punjab | 50 |
| 2. The Punjab Stock Exchange Ltd. | 56 |
| 3. Lahore Central Stock Exchange Ltd. | 23 |

U. P.

- | | |
|--|----|
| The U. P. Stock Exchange Association, Cawnpore | 35 |
|--|----|

DELHI

- | | |
|---|-----|
| 1. Delhi Stock & Share Brokers' Association, Ltd. | 77 |
| 2. Delhi Stock Exchange Ltd. | 100 |

* These numbers include many card holders who are not stock brokers or dealers by profession.

CHAPTER III.

THE SECURITIES—THEIR NUMBER, VALUE & DISTRIBUTION.

What are the securities traded in the stock markets of India? Of what companies (textiles, engineering, etc.) are they, and what classes of issues (ordinary, preference, deferred, etc.)? What are the total number and value of the securities (of various categories)? How have the prices of securities moved in recent years? Among how many holders are the securities distributed? What is the stake of the nation? It is proposed to answer these and allied questions briefly in this chapter, as these may help in assessing the present position of the stock market in India.

2. In other countries, especially in the U.S.A., the stock exchanges publish periodically all kinds of information regarding the number and value of securities listed, details regarding the different issues, the volume of daily transactions, prices of stock, member borrowings. In India, only the Calcutta Stock Exchange issues an official handbook and even this contains very little information about the above points. The various investors' handbooks, although full of details regarding numerous companies, are not very helpful for a statistical study of the stock market. Further these publications are much out of date, owing chiefly to war. Trading lists are indeed regularly issued by the stock exchanges, but many of these give only the bare names of companies, without details of the various issues. In the result, there is great difficulty in drawing up detailed statistics regarding securities in India.

3. In regard to companies themselves, Government should have information gathered under the Indian Companies Act. Some such information is collected in the Provincial Governments, and communicated to the Department of Commercial Intelligence and Statistics, at Calcutta. Before the war, that office had been publishing the principal data regarding the companies, but in war-time, this publication was discontinued. Even before the war, the publication did not give details regarding the capital structure. All this makes it difficult to get detailed information on some of the questions raised above. It is clear that a great deal of spade work will be required before the statistics needed for formulating a proper national investment policy can be gathered.

Public Securities.

4. Securities are issued by Government, Central and Provincial, and by State administrations, municipalities, port trusts or other public bodies. They fall under the following groups:—

(1) Central Government Securities:

(i) non-terminable loans.

(ii) terminable loans.

(2) Provincial Government Securities.

(3) Other public loans:

Municipal Loans.

Port Trust Loans.

Improvement Trust Loans.

(4) Indian State Securities.

(See appendix—for details).

Industrial Securities.

5. From the point of view of stock market speculation, securities issued by joint stock companies are more important (although smaller in total value). The growth of joint stock enterprise in India in recent years can be seen from the number and paid-up capital of the companies in British India and All India for certain years:—

TABLE 1.
and
Number ~~of~~ Capital of Joint Stock Companies in India in Certain Years.

| Year. | Total Number. | | (In lakhs Rs.) Total paid-up Capital. | |
|---------|---------------|------------|--|------------|
| | Br. India. | All India. | Br. India. | All India. |
| 1919-20 | 3,500 | 3,668 | 119.46 | 123.21 |
| 1924-25 | 4,822 | 5,204 | 266.50 | 275.53 |
| 1929-30 | 6,009 | 6,615 | 249.97 | 261.11 |
| 1934-35 | 8,934 | 9,627 | 266.60 | 279.25 |
| 1939-40 | 10,362 | 11,372 | 288.44 | 303.68 |
| 1942-43 | 11,783 | 12,770 | 316.38 | 336.13 |
| 1943-44 | 12,499 | 13,689 | 329.79 | 353.74 |
| 1944-45 | 13,555 | 14,859 | 360.73 | 388.97 |

(See Appendix—for fuller details).

6. Thus we see that at the end of March 1945, 14,859 companies, with a total paid-up capital of Rs. 388.96 crores, were working in India. They can be classified as follows:—

TABLE 2.
Classified List of Joint Stock Companies in British India (1944-45).

| | No. of Cos. | | (In lakhs). Paid-up Capital. | |
|---------------------|-------------|------------|---------------------------------|------------|
| | Br. India. | All India. | Br. India. | All India. |
| Banks | 2,118 | 2,434 | 43.54 | 50.45 |
| Transport | 853 | 896 | 24.16 | 25.22 |
| Trade & Manufacture | 7,205 | 7,851 | 1,41.10 | 1,47.75 |
| Mills & Presses | 1,138 | 1,253 | 79.48 | 87.55 |
| Plantation | 587 | 701 | 17.14 | 20.44 |
| Mining | 437 | 447 | 21.35 | 22.16 |
| Estate, Land | 360 | 369 | 15.36 | 15.55 |
| Breweries | 26 | 29 | 90 | 98 |
| Sugar | 157 | 165 | 13.41 | 14.35 |
| Hotels | 495 | 518 | 3.44 | 3.61 |
| Others | 179 | 196 | 85 | 90 |
| Total | 13,555 | 14,859 | 3,60.73 | 3,88.96 |

7. Of the above 14,859 companies (All India) only about 1,125 are found listed in the stock exchanges of the eight cities in British India where there are stock exchanges. Of these 1,125 companies, details have been gathered of only 1057 with 1506 issues and a total paid-up capital of Rs. 270.40 crores (besides 60 sterling and other foreign companies). Of the remaining 13,500 companies, the majority must be companies with small capital, (although this need not be a

proper measure of the total capital invested, seeing that many companies, especially textile companies in Bombay Province, use a great deal of borrowed capital, in some cases several times the paid-up capital). Several must be private limited companies, which do not need the services of the stock exchange. Several public limited companies too may not be listed on the stock exchanges, because they either do not conform to the listing requirements of stock exchanges or because they have ample means of sale through independent stock brokers or otherwise. This is the case in other countries also. At any rate, so far as the stock market speculation is concerned, only the issues of about 1,500 companies (at the outside) are of any consequence.

8. Listing is given not only to ordinary shares but also to deferred and preference shares and debentures. The issue of preference shares is fairly common among Indian companies, but this is most pronounced in the case of jute and cotton companies. Most of the jute companies have issued preference shares and in the case of a large number of them such shares form nearly half the capital. On the other hand, only a few of the coal companies issue preference shares and in the case of banks and railway companies, issue of preference shares is very rare. Deferred shares, known also as founders' shares, receive no dividend until preference and ordinary shares have been paid their prescribed respective dividends. In India, as will be shown in a later chapter, deferred shares have lately been used to give too disproportionate a voting power to promoters or founders of companies or underwriters.

9. Of a different category are bonds and debentures, which are creditorship securities. When a specific property is mortgaged for a loan the security is termed 'bond' while if the security of the loan depends on the general credit of the issuing company it is called 'debenture.' Bonds are very common in the U. S. A. In India debentures are more used, but even these not very popular.

10. We have been able to obtain the trading lists from the stock exchanges of eight leading cities, and the analysis of the data is contained in the table below. In table one, the total number of companies and issues on the list of each stock exchange is given. As about 128 of the leading companies (204 issues) are being traded on more than one exchange, there is a great deal of overlapping in table 3. Therefore a different arrangement is adopted in table 4.

TABLE 3.
Number and Paid-up Capital of Companies listed on the Stock Exchanges

| Stock exchange | Scripts. | | Capital. | |
|----------------|-------------|----------------|--|---|
| | No. of Cos. | No. of Issues. | No. of cos. for which figures are available. | Paid up Capital of those (Lakhs of Rs.) |
| Calcutta* | 576 | 807 | 576 | 147.49 |
| Bombay* | 197 | 271 | 197 | 123.32 |
| Madras | 192 | 298 | 192 | 40.57 |
| U. P. | 40 | 40 | 37 | 48.78 |
| Punjab* | 141 | 162 | 118 | 57.55 |
| Ahmedabad* | 81 | 82 | 56 | 15.41 |
| Delhi | 73 | 92 | 60 | 72.92 |
| Nagpur | 40 | 43 | 35 | 42.27 |

* The figures for the Calcutta Stock Exchange Association in the case of Calcutta, and the recognised Exchanges in the case of Bombay, Punjab and Ahmedabad.

TABLE 4.

| | Total No. of companies | No. of cos. about which information is available. | No. of their issues. | Their paid-up capital (lakhs.) | Sterling & other foreign cos. not included. |
|--------------------------------|------------------------|---|----------------------|--------------------------------|---|
| Listed on more than one | | | | | |
| Stock Exchange | 128 | 128 | 201 | 101.17 | 4 |
| On Calcutta only | 500 | 500 | 755 | 81.66 | 49* |
| On Bombay only | 131 | 129 | 145 | 42.90 | 4 |
| On Madras only | 161 | 161 | 256 | 24.32 | 1 |
| On U. P. only | 9 | 6 | 6 | 1.09 | 1 |
| On Punjab only | 80 | 59 | 66 | 4.38 | 1 |
| On Ahmedabad only | 77 | 51 | 51 | 3.72 | |
| On Delhi only | 20 | 9 | 10 | 6.50 | |
| On Nagpur only | 16 | 11 | 13 | 1.66 | |
| Total | 1,125 | 1,057 | 1,506 | 270.40 | 60 |

* Includes Malayan Rubber Companies.

11. Having grouped the listed securities exchange-wise, we may now see what proportion of them are banks, textiles, etc. For this classification, it has been possible to take only 1399 issues of 969 companies.

TABLE 5.
Listed Scripts Classified under different categories.

| Class of Companies. | No. of Cos. for which information is available. | No. of their issues. | Number of Shares. | | | |
|---------------------|---|----------------------|--------------------|-------------------|-------------------|--------------------|
| | | | Ordy. | Pref. | Defd. | Total. |
| Banks | 49 | 73 | 10,660,671 | 166,090 | 709,850 | 11,536,611 |
| Insurance | 35 | 40 | 3,141,635 | 487,967 | | 3,629,602 |
| Cotton Mills | 122 | 180 | 14,238,131 | 1,258,838 | 6,025,095 | 21,522,064 |
| Jute Mills | 60 | 114 | 5,516,688 | 810,814 | 30,000 | 6,387,502 |
| Engineering | 33 | 51 | 8,255,078 | 1,062,484 | 115,233 | 9,732,795 |
| Sugar | 57 | 84 | 6,149,358 | 372,971 | 95,000 | 6,617,329 |
| Electric | 70 | 95 | 4,767,225 | 980,091 | | 5,747,316 |
| Railways | 21 | 23 | 836,144 | 46,000 | | 882,144 |
| Coals | 67 | 79 | 8,002,745 | 401,173 | | 8,403,918 |
| Plantations | 214 | 281 | 17,768,888 | 1,548,036 | | 19,316,924 |
| Miscellaneous | 241 | 376 | 56,501,165 | 3,228,176 | 2,865,653 | 62,605,004 |
| Total | 969 | 1,399 | 135,938,028 | 10,402,610 | 10,140,811 | 156,481,509 |

12. In table 5 above, the total number of shares of 969 listed companies are also given, grouped under the different classes of shares. Of a total of 156.4 million shares, 135.9 million are ordinary shares, 10.4 million deferred shares and 10.1 million preference shares. It is noteworthy that while the total number of issues listed on the New York Stock Exchange at the end of February 1947 was only 1343 (less that on Indian stock exchanges) the total number of shares came to 1786 millions and their total market value 68.839 million dollars (about Rs. 20,700 crores). The total market value of all listed shares in India came to only Rs. 971 crores in March 1947.

Listed Securities on the Calcutta Stock Exchange.

13. We will now survey the security lists of the leading stock exchanges. Taking first the Calcutta Stock Exchange, which has the largest number of scrips on the list, we find 28 Government securities (Central and Provincial), 23 Calcutta Port Trust securities, 7 Calcutta Improvement Trust Securities, and 29 Calcutta Municipal Debentures and 59 debentures of joint stock companies and 647 equities (ordinary shares) 201 preference shares and 16 deferred shares, of joint stock companies.

14. Table 6 gives details of the company shares (ordinary and other) listed on the Calcutta stock exchange. Table 7 gives a classified list of companies quoted on that Exchange showing the position of the different categories of companies from 1923 to 1947.

TABLE 6.

The classified list of companies in the Calcutta Stock Exchange (1947).

| Class of Cos. | No. of Cos. | No. of issues. | Ordinary issues. | Pref. issues. | Defd. issues. |
|---------------------------|----------------|-------------------|---------------------|------------------|------------------|
| Bank and Finance | 10 | 26 | 22 | 4 | .. |
| Railways | 20 | 23 | 21 | 2 | .. |
| Coals | 68 | 81 | 70 | 11 | .. |
| Cotton Mills | 22 | 38 | 22 | 14 | 2 |
| Jute Mills | 61 | 115 | 62 | 53 | .. |
| Mining | 11 | 15 | 11 | 2 | 2 |
| Cement, Pottery, etc. | 6 | 10 | 6 | 2 | 2 |
| Chemicals | 10 | 15 | 10 | 5 | .. |
| Electric Cos. | 31 | 37 | 32 | 5 | .. |
| Engineering & Metal Work | 26 | 40 | 27 | 11 | 2 |
| Flour Mills | 4 | 4 | 4 | .. | .. |
| Insurance Companies | 12 | 12 | 12 | .. | .. |
| Miscellaneous | 72 | 111 | 77 | 28 | 6 |
| Oil | 6 | 9 | 6 | 3 | .. |
| Paper Mills | 8 | 17 | 8 | 9 | .. |
| Pressing Companies | 7 | 9 | 7 | 2 | .. |
| Real Property & Zemindari | 10 | 19 | 12 | 6 | 1 |
| Rubber | 45 | 46 | 45 | 1 | .. |
| Saw Mills & Timber | 3 | 4 | 3 | 1 | .. |
| Shipping | 9 | 12 | 9 | 3 | .. |
| Sugar | 43 | 60 | 44 | 15 | 1 |
| Tea | 136 | 161 | 137 | 24 | .. |
| Total | 629 | 861 | 647 | 201 | 16 |

TABLE 7.

Classified List of Companies quoted on the Calcutta Stock Exchange in different years.

| Class of companies. | 1923 | 1933 | 1943 | 1944 | 1945 | 1947 |
|---------------------|------|------|------|------|------|------|
| Banks | 12 | 12 | 11 | 13 | 17 | 19 |
| Railways | 22 | 22 | 20 | 20 | 20 | 20 |
| Coals | 133 | 64 | 56 | 52 | 59 | 68 |
| Cotton Mills | 16 | 13 | 22 | 22 | 22 | 22 |
| Jute Mills | 50 | 51 | 60 | 61 | 61 | 61 |
| Mining | 18 | 12 | 15 | 15 | 10 | 11 |
| Chemical Cos. | 8 | 5 | 9 | 9 | 10 | 10 |
| Electric Cos. | 5 | 24 | 28 | 28 | 29 | 31 |
| Engineering | 34 | 18 | 24 | 25 | 25 | 26 |
| Flour Mills | 7 | 6 | 5 | 4 | 4 | 4 |
| Insurance Cos. | 3 | 4 | 10 | 10 | 12 | 12 |
| Miscellaneous | 46 | 24 | 48 | 48 | 57 | 78 |
| Oil Cos. | 10 | 5 | 4 | 6 | 6 | 6 |
| Paper Mills | 3 | 4 | 8 | 8 | 8 | 8 |
| Pressing Cos. | 8 | 5 | 6 | 6 | 6 | 7 |
| Real Estates | 5 | 6 | 6 | 6 | 7 | 10 |
| Rubber Cos. | 2 | 57 | 45 | 45 | 45 | 45 |
| Saw Mills | 8 | 3 | 3 | 3 | 3 | 3 |
| Shipping Cos. | 8 | 7 | 7 | 7 | 7 | 9 |
| Tea Cos. | 116 | 131 | 131 | 133 | 133 | 136 |
| Sugar Mills | 12 | 17 | 41 | 40 | 41 | 43 |
| Total | 525 | 490 | 559 | 561 | 582 | 629 |

14. It may be seen from the above that among the companies on the Calcutta Stock Exchange list, coal mines (68), Jute mills (61), Sugar mills (43), Engineering metal works (26), Electrical companies (31), Tea companies (136) and Rubber companies (mainly Malayan) (45) predominate. On the other hand, textiles and banks predominate in Bombay and plantations and spinning mills in Madras. Information available regarding the companies and the various issues on the lists of the Bombay Stock Exchange and Madras Stock Exchange respectively is given below in tables 8 and 9.

TABLE 8.

BOMBAY.

| Class of Cos. | No. of Cos. listed. | Issues. | | | | Paid-up capital (in lakhs of Rs.) |
|------------------------------|------------------------|---------|------|-------|-------|--|
| | | Total. | Ord. | Pref. | Defd. | |
| Banks | 26 | 28 | 26 | 2 | | 35.08 |
| Textiles, Spng. & Weaving | 56 | 74 | 59 | 12 | 3 | 18.07 |
| Railways | 3 | 4 | 4 | | | 1.97 |
| Electric | 17 | 29 | 20 | 9 | | 17.77 |
| Insurance | 15 | 18 | 16 | 2 | | 2.38 |
| Steel | 5 | 9 | 5 | 3 | 1 | 18.74 |
| Shipping | 2 | 3 | 2 | 1 | | 5.06 |
| Miscellaneous | 73 | 106 | 76 | 26 | 4 | 24.25 |
| Total | 197 | 271 | 208 | 55 | 8 | 123.32 |

TABLE 9.

MADRAS.

| Class of Cos. | No. of Cos. listed. | Issues. | | | Paid-up capital (in lakhs of Rs.) |
|--------------------|------------------------|---------|------|-------|--|
| | | Total. | Ord. | Pref. | |
| Banks | 11 | 16 | 16 | | 13.54 |
| Insurance | 5 | 5 | 5 | | 4.3 |
| Electric | 21 | 32 | 21 | 11 | 1.33 |
| Sugars & Breweries | 9 | 16 | 11 | 5 | 1.19 |
| Plantations | 76 | 122 | 76 | 46 | 7.16 |
| Textiles | 37 | 53 | 39 | 14 | 7.12 |
| Miscellaneous | 33 | 54 | 33 | 21 | 9.80 |
| Total | 192 | 298 | 201 | 97 | 40.57 |

Changes in Security Prices.

16. Changes in the price of securities are a most important factor, with wide repercussions on banking and credit, and on the national economy as a whole. For many years (till September, 1946), market values of securities had been generally on the increase. The rise has been least in the case of Government securities, and largest in the case of variable-yield industrial securities; a moderate rise has taken place in the case of fixed-yield industrial securities also. The trends of security prices can be seen from the monthly indices issued by the Economic Adviser to the Government of India (see table 10 and the graph facing p. 5). The base year for this index is 1927-28. Prices of 83 securities have been taken for the construction of this index. Of these, 22 are cotton textiles, 20 jute companies, 19 tea companies, 3 sugar mills, 3 iron and steel mills, etc.

TABLE 10.

Index Numbers of Prices of Indian Security.

(1927-28 = 100)

| | | Government Securities. | Fixed Yield Industrial Securities. | Variable Yield Industrial Securities. |
|-------------|----|---------------------------|--|---|
| 1939 | | | | |
| August | .. | 117.6 | 137.7 | 98.5 |
| September | .. | 103.8 | 127.8 | 111.4 |
| October | .. | 107.1 | 130.6 | 111.9 |
| November | .. | 110.5 | 131.5 | 124.7 |
| December | .. | 111.2 | 135.1 | 130.7 |
| 1940 | | | | |
| January | .. | 113.6 | 136.1 | 120.9 |
| April | .. | 116.9 | 142.4 | 123.0 |
| July | .. | 112.6 | 139.7 | 111.7 |
| October | .. | 114.8 | 146.2 | 114.2 |
| December | .. | 116.4 | 154.6 | 119.3 |
| 1941 | | | | |
| January | .. | 117.3 | 155.7 | 121.2 |
| April | .. | 115.8 | 157.2 | 118.2 |
| July | .. | 117.9 | 159.9 | 129.2 |
| October | .. | 118.0 | 163.5 | 138.8 |
| December | .. | 116.2 | 155.8 | 132.1 |
| 1942 | | | | |
| January | .. | 116.3 | 157.2 | 128.5 |
| February | .. | 108.5 | 142.8 | 121.7 |
| March | .. | 109.8 | 131.2 | 119.6 |
| April | .. | 110.5 | 130.4 | 119.1 |
| May | .. | 112.3 | 131.0 | 122.8 |
| June | .. | 113.4 | 137.0 | 124.3 |
| July | .. | 115.2 | 141.1 | 126.8 |
| August | .. | 115.5 | 142.2 | 127.4 |
| September | .. | 116.1 | 147.7 | 136.3 |
| October | .. | 116.2 | 148.5 | 140.2 |
| November | .. | 116.3 | 150.4 | 149.2 |
| December | .. | 116.2 | 153.5 | 143.7 |

| | | Government Securities. | Fixed Yield Industrial Securities. | Variable Yield Industrial Securities. |
|-------------|----|---------------------------|--|---|
| 1943 | | | | |
| January | .. | 116.1 | 152.0 | 152.7 |
| February | .. | 116.1 | 153.6 | 158.3 |
| March | .. | 116.1 | 157.1 | 162.8 |
| April | .. | 116.1 | 157.9 | 174.5 |
| May | .. | 115.8 | 159.8 | 170.7 |
| June | .. | 116.1 | 160.2 | 174.8 |
| July | .. | 116.8 | 160.8 | 168.8 |
| August | .. | 117.0 | 162.9 | 170.9 |
| September | .. | 117.3 | 164.1 | 176.3 |
| October | .. | 117.5 | 165.3 | 183.1 |
| November | .. | 117.6 | 165.6 | 188.9 |
| December | .. | 117.6 | 165.7 | 186.8 |
| 1944 | | | | |
| January | .. | 118.3 | 168.3 | 200.1 |
| February | .. | 118.2 | 169.1 | 196.2 |
| March | .. | 117.7 | 171.6 | 195.3 |
| April | .. | 117.5 | 171.4 | 190.7 |
| May | .. | 117.9 | 172.3 | 197.2 |
| June | .. | 118.1 | 173.0 | 198.9 |
| July | .. | 118.2 | 173.2 | 203.6 |
| August | .. | 118.2 | 174.3 | 194.3 |
| September | .. | 118.0 | 174.4 | 187.7 |
| October | .. | 118.2 | 177.6 | 191.2 |
| November | .. | 118.2 | 178.2 | 196.1 |
| December | .. | 118.1 | 178.2 | 202.8 |
| 1945 | | | | |
| January | .. | 117.8 | 180.2 | 200.8 |
| February | .. | 117.7 | 180.5 | 204.6 |
| March | .. | 117.6 | 181.2 | 199.9 |
| April | .. | 117.6 | 181.9 | 199.8 |
| May | .. | 117.7 | 181.5 | 202.2 |
| June | .. | 118.2 | 183.5 | 207.3 |
| July | .. | 118.4 | 186.2 | 217.0 |
| August | .. | 118.0 | 187.7 | 212.6 |
| September | .. | 118.3 | 187.4 | 213.3 |
| October | .. | 118.7 | 187.3 | 214.9 |
| November | .. | 119.3 | 187.7 | 225.3 |
| December | .. | 119.0 | 189.0 | 232.4 |

| | | Government Securities. | Fixed Yield Industrial Securities. | Variable Yield Industrial Securities. |
|-------------|----|---------------------------|--|---|
| 1946 | | | | |
| January | .. | 119.3 | 189.8 | 238.6 |
| February | .. | 119.2 | 190.8 | 236.7 |
| March | .. | 119.2 | 191.3 | 249.7 |
| April | .. | 119.8 | 193.8 | 259.8 |
| May | .. | 119.4 | 195.9 | 267.3 |
| June | .. | 120.7 | 200.5 | 280.9 |
| July | .. | 121.9 | 202.8 | 303.8 |
| August | .. | 122.8 | 204.0 | 314.9 |
| September | .. | 121.2 | 200.9 | 282.0 |
| October | .. | 121.5 | 198.5 | 265.5 |
| November | .. | 121.5 | 198.4 | 264.6 |
| December | .. | 120.7 | 197.6 | 252.6 |
| 1947 | | | | |
| January | .. | 119.7 | 196.4 | 256.3 |
| February | .. | 117.4 | 193.2 | 239.3 |
| March | .. | 117.8 | 191.5 | 235.6 |
| April | .. | 118.0 | 176.4 | 217.7 |
| May | .. | 117.9 | 171.5 | 215.2 |

Aggregate Market Values of Securities.

17. It is also possible on the basis of price changes to estimate the aggregate market values of these securities in various years. In July 1946, prices of several securities stood at 8 times their par value. Even if we take all the listed securities, prices stood at more than 5 times their par value. In terms of pre-war prices the increase in listed securities was about 3.4 times. Prices have declined considerably since.

18. It might be thought that calculations like the above have little real meaning, as only a small proportion of the total shares of each issue are actually traded in the market, but it must be remembered that the scrips which are bought and sold set the value of all the shares in the security concerned. It may be that if a large number of shares is offered for sale, the price will go down. But this notwithstanding, when the price of a security is rising, all those who hold that scrip has an addition to their credit, and whether they sell their holding or not, they are able to convert that credit into cash through banks and use it for the purchase of goods.

19. For the purpose of table 11, only shares of companies listed on the Indian stock exchanges (i.e. 969 companies with a capital of 260.40 crores) have been taken into account. For making estimates, the prices of 84 securities, selected on a random sampling basis, have been used. It must be noted that the increase of market values is taken with reference to their par value. The market values of the securities were 55 per cent above par in 1939, and hence the difference between the figures in table 10, column 3 and in this table.

TABLE 11

Classified List of Joint Stock Companies quoted on Stock Exchanges with their Aggregate Capital in August, 1939, September, 1945, July, 1946 and March, 1947.

| Class of Companies. | No. of Cos. for which information is available. | Paid-up capital (in lakhs of Rs.) | Per Rs. 100 in Aug., 1939. | Total value in Aug., 1939 (in lakhs of Rs.) | Per Rs. 100 in Sept., 1945. | Total value in Sept., 1945 (in lakhs of Rs.) | Per Rs. 100 in July, 1946. | Total value in July, 1946 (in lakhs of Rs.) | Per Rs. 100 in March, 1947. | Total value in March, 1947 (in lakhs of Rs.) |
|---------------------|---|-----------------------------------|----------------------------|---|-----------------------------|--|----------------------------|---|-----------------------------|--|
| Banks | 49 | 32.61 | 164 | 53.48 | 258 | 84.13 | 333 | 108.59 | 281 | 91.63 |
| Insurance | 35 | 5.04 | 342 | 17.24 | 575 | 28.98 | 791 | 39.87 | 555 | 27.97 |
| Cotton Mills | 122 | 32.98 | 106 | 54.75 | 575 | 189.64 | 857 | 282.64 | 600 | 197.88 |
| Jute Mills | 60 | 18.74 | 196 | 36.73 | 420 | 78.71 | 820 | 153.67 | 499 | 93.51 |
| Engineering | 33 | 23.03 | 185 | 42.61 | 380 | 87.51 | 610 | 140.48 | 391 | 90.05 |
| Sugar | 57 | 8.77 | 169 | 14.82 | 362 | 31.75 | 462 | 40.52 | 373 | 32.71 |
| Electric | 70 | 24.78 | 160 | 39.65 | 211 | 52.29 | 226 | 56.00 | 180 | 44.60 |
| Railways | 21 | 6.79 | 92 | 6.25 | 108 | 7.33 | 113 | 7.67 | 111 | 7.54 |
| Coals | 67 | 8.47 | 166 | 14.06 | 393 | 33.29 | 566 | 47.94 | 373 | 31.59 |
| Plantations | 214 | 13.64 | 128 | 17.46 | 272 | 37.10 | 331 | 51.97 | 351 | 47.88 |
| Miscellaneous | 241 | 85.55 | 126 | 107.79 | 337 | 288.30 | 545 | 466.25 | 358 | 306.27 |
| Total | 969 | 260.40 | ... | 404.84 | ... | 919.03 | ... | 1395.60 | ... | 971.63 |
| | | | | 155% Par | | 353% Par | | 536% Par | | 373% Par |

It is clear from the above table (11) that of all the groups, the increase in value was largest in the case of textiles, both cotton and jute, being as much as eight times the par value. Next came insurance companies, engineering and coal mines. Public utility concerns like railways and electric companies have had much less increase. The fall of prices since September 1946 affected naturally concerns whose values got bloated up in the boom period. The total values which had risen to above 5 times the par value fell subsequently to below 4 times par, and may be standing at about 3 times par now (May 1947).

THE STAKE OF THE NATION.

Who owns the Securities ?

19. In the case of the U. S. A. it is estimated that one in every ten persons, or one out of three families owns stocks. Estimates have also been made of the geographical distribution of stock holdings and changes in the same from time to time. In regard to India no such estimate has been made nor are the data for such estimates readily available. It is certain that the proportion of individuals holding stock or bonds is much less in this country than in the U. S. A. But among sections of people accustomed to such investment, the per capita holding cannot be small. Owning securities is much more common in Provinces like Bombay and Bengal than in Madras, the C. P., Bihar, Orissa, Assam and perhaps U. P. too. Even in the first two Provinces only certain classes habitually put their money in securities while others hardly ever. In the Province of Bombay, the proportion of people owning securities must be much larger in Gujrat than in the Maharashtra and Karnataka parts of the country.

20. It is generally believed that in India securities are owned by a few wealthy persons. No doubt the proportion of people holding securities is much smaller in India than say in the U. K. or the U. S. A. But in the last two or three decades the habit of investing in stock has spread widely among people of the professional and salaried classes. According to certain calculations made by the Bombay Shareholders' Association, it is found that as much as 90 per cent. of the total number of shares in many companies is held by persons who hold up to 50 shares. The following table has been supplied to me by the Bombay Shareholders' Association :—

TABLE 12.

Statement indicating the state of small and middleclass holdings of Ordinary Shares in representative companies like Banking, Insurance, Shipping, Cotton Textile, Sugar, Iron and Steel, Cement, Electricity, etc.

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|------------|---|---------------------------------------|---|---|--|--|
| Serial No. | Number of Ordinary shareholders in the Coy. | Number of Ordinary Shares in the Coy. | Range of small & middle class shareholding. | Number of shareholders holding shares covered by the range. | Number of shares covered by the range. | Approximate percentage of col. 5 to 2. |
| 1 | 2,725 | 75,196 | 1 to 50 | 2,538 | 30,005 | 93 |
| 2 | 22,450 | 1,054,000 | 1 to 50 | 264,000 | 18,500 | 82 |
| 3 | 9,760 | 350,000 | 1 to 50 | 8,970 | ..... | 92 |
| 4 | 7,770 | 2,500,000 | 1 to 20,000 | 7,685 | 1,466,510 | 98.5 |
| 5 | 20,400 | 1,047,000 | 1 to 200 | 19,600 | 513,600 | 96 |
| 6 | 10,800 | 475,000 | 1 to 100 | 10,550 | 257,300 | 97.5 |
| 7 | 24,700 | 3,000,000 | 1 to 300 | 22,450 | 1,128,000 | 90 |
| 8 | 5,660 | 180,000 | 1 to 50 | 5,210 | 65,460 | 92 |

Note :—The above figures are approximate. Each of the eight items refers to one company only according as it is engaged in each one of the eight businesses referred to above. All the eight companies are Bombay companies.

21. It is no doubt clear that the ownership of securities in many companies is spread over a large number of shareholders. But it is not possible to say if they are all "small" investors, seeing that many of them might have invested similar sums in other companies also. Even so, it must be admitted that the stake is widespread, although within a limited class.

22. For assessing the stake of the nation, we have also to take into account the advances made by banks against shares and the large sums invested in them by insurance companies, charitable societies, hospitals, schools and universities in securities. Of the advances on shares by banks, we have no complete statistics but the advances by scheduled bank classified according to the margin allowed are given in the following table, supplied by the Reserve Bank of India :—

TABLE 13.
Consolidated Statement of advances against shares made by Scheduled Banks.

| Margin. | Outstanding as on 30-11-1945. | Outstanding as on 24-5-1946. |
|-----------------|----------------------------------|---------------------------------|
| Less than 5% | 1,50,18,754 | 1,13,04,062 |
| Between 5 & 10% | 31,47,376 | 47,92,609 |
| " 10 & 15% | 31,54,681 | 35,93,611 |
| " 15 & 20% | 43,16,388 | 50,10,085 |
| " 20 & 25% | 1,09,89,985 | 1,72,32,423 |
| " 25 & 30% | 2,70,34,610 | 3,18,79,439 |
| " 30 & 35% | 7,41,64,264 | 10,05,09,745 |
| " 35 & 40% | 2,06,57,152 | 3,67,71,076 |
| " 40 & 45% | 7,86,65,192 | 14,51,38,383 |
| " 45 & 50% | 1,40,04,471 | 1,72,83,007 |
| Above 50% | 5,67,98,926 | 11,48,48,934 |
| | <u>30,79,51,799</u> | <u>48,83,63,277</u> |

23. Of the assets of all Indian Insurance Companies amounting to Rs. 1,38 crores in December 1945, the following had been invested in securities :—

| Item. | (Rs. in crores). |
|---|------------------|
| Indian Government Securities | 87.20 |
| Securities of Indian States | .95 |
| British, Colonial and Foreign Government Securities | 1.31 |
| Municipality, Port Trust and Improvement Trust Securities | 6.86 |
| Shares of Indian Companies | 13.04 |
| Total | <u>109.36</u> |

APPENDIX A.

Growth of Joint Stock Companies in India:
Number and Paid-up Capital.

| Year. | BRITISH INDIA | | INDIAN STATES | | (Paid-up Capital in Rs. Lakhs). TOTAL: INDIA | |
|---------|----------------|---------------------|----------------|---------------------|---|---------------------|
| | No. of Cos. | Paid-up Capital. | No. of Cos. | Paid-up Capital. | No. of Cos. | Paid-up Capital. |
| 1914-15 | 2,480 | 80.24 | 65 | 55 | 2,545 | 80.79 |
| 1915-16 | 2,411 | 84.57 | 65 | 46 | 2,476 | 85.03 |
| 1916-17 | 2,448 | 90.42 | 65 | 47 | 2,513 | 90.89 |
| 1917-18 | 2,597 | 98.61 | 71 | 51 | 2,668 | 99.12 |
| 1918-19 | 2,713 | 1,06.09 | 76 | 53 | 2,789 | 1,06.62 |
| 1919-20 | 3,500 | 1,19.46 | 168 | 3.75 | 3,668 | 1,23.21 |
| 1920-21 | 4,283 | 1,58.31 | 425 | 6.15 | 4,708 | 1,64.46 |
| 1921-22 | 4,781 | 2,22.84 | 408 | 7.71 | 5,189 | 2,30.55 |
| 1922-23 | 4,785 | 2,49.85 | 405 | 9.93 | 5,190 | 2,59.78 |
| 1923-24 | 4,820 | 2,54.55 | 391 | 10.78 | 5,211 | 2,65.33 |
| 1924-25 | 4,822 | 2,66.50 | 382 | 9.03 | 5,204 | 2,75.53 |
| 1925-26 | 4,926 | 2,67.79 | 379 | 9.17 | 5,305 | 2,76.96 |
| 1926-27 | 5,156 | 2,67.09 | 370 | 9.81 | 5,526 | 2,76.90 |
| 1927-28 | 5,388 | 2,66.71 | 442 | 9.72 | 5,830 | 2,76.43 |
| 1928-29 | 5,795 | 2,69.12 | 535 | 10.19 | 6,330 | 2,79.31 |
| 1929-30 | 6,009 | 2,49.97 | 606 | 11.14 | 6,615 | 2,61.11 |
| 1930-31 | 6,387 | 2,44.73 | 653 | 11.40 | 7,040 | 2,56.13 |
| 1931-32 | 6,808 | 2,47.52 | 905 | 11.68 | 7,713 | 2,59.20 |
| 1932-33 | 7,252 | 2,47.52 | 1,175 | 11.94 | 8,427 | 2,59.46 |
| 1933-34 | 8,346 | 2,63.52 | 894 | 12.56 | 9,240 | 2,76.07 |
| 1934-35 | 8,934 | 2,66.60 | 693 | 12.65 | 9,627 | 2,79.25 |
| 1935-36 | 9,467 | 2,64.31 | 917 | 13.18 | 10,384 | 2,77.49 |
| 1936-37 | 10,061 | 2,72.24 | 890 | 13.52 | 10,951 | 2,85.77 |
| 1937-38 | 9,677 | 2,64.05 | 980 | 15.13 | 10,657 | 2,79.17 |
| 1938-39 | 10,070 | 2,75.42 | 1,044 | 14.97 | 11,114 | 2,90.39 |
| 1939-40 | 10,362 | 2,88.44 | 1,010 | 15.24 | 11,372 | 3,03.68 |
| 1940-41 | 10,658 | 2,92.98 | 980 | 16.60 | 11,638 | 3,09.58 |
| 1941-42 | ..... | ..... | ..... | ..... | ..... | ..... |
| 1942-43 | 11,783 | 3,16.38 | 987 | 19.75 | 12,770 | 3,36.13 |
| 1943-44 | 12,499 | 3,29.79 | 1,190 | 23.95 | 13,689 | 3,53.74 |
| 1944-45 | 13,555 | 3,60.74 | 1,304 | 28.23 | 14,859 | 3,88.97 |
| 1945-46 | ..... | ..... | ..... | ..... | ..... | ..... |

APPENDIX E.

List of Government and other Public Securities.

| | | Rupee Securities (in lakhs of Rs.) | Sterling Securities (in £). |
|------------------------------------|---------------------------------------|--|-----------------------------------|
| Central Govt. Securities. | | | |
| As on | Govt. of India Rupee Loans | | |
| 31-5-46 | (i) Non-terminable loans | 2,82 | |
| | (ii) Terminable loans | 12,35.69 | |
| 31-3-45 | Govt. of India Sterling loans | .... | 9,976 |
| | Total (Central) | 12,38.51 | 9,976 |
| Provincial Govt. Securities | | | |
| 1-4-46 | Govt. of Punjab loans | 19.32 | |
| 1-1-46 | Govt. of U. P. loans | 15.04 | |
| 1-1-46 | Govt. of C. P. and Berar loans | 2.73 | |
| 1-1-46 | Govt. of N. W. F. P. loans | 57 | |
| 1-4-46 | Govt. of Madras loans | 15.55 | |
| 31-12-46 | Govt. of Assam loans | 50 | |
| 26-8-46 | Govt. of Bombay loans | 10.48 | |
| | Total (Provincial) | 64.19 | |
| | Total (Central and Provincial) | 13,02.70 | 9,976 |
| Other Public Securities. | | | |
| 31-12-45 | Madras Port Trust loans | 3.30 | |
| 1-1-46 | New Howrah Bridge loans | 2.84 | |
| 31-3-46 | Corporation of Calcutta | | |
| | Rupee loans | 7.04 | |
| | Sterling loans | | 500,000 |
| 31-3-46 | Corporation of Bombay | 8.59 | |
| 22-4-46 | Corporation of Madras | 61 | |
| | Madras Port Trust | 1.93 | |
| | Bombay Port Trust | 10.34 | 1,600,000 |
| 1-1-46 | Karachi Port Trust | 1.47 | 666,000 |
| 1-1-46 | Calcutta Port Trust | 15.58 | 5,164,900 |
| 31-3-46 | Bombay Improvement Trust | 5.99 | 899,600 |
| 1-1-46 | Calcutta Improvement Trust | 2.60 | |
| | Total (Others) | 60.29 | 8,830,500 |
| | GRAND TOTAL | 13,62.99 | 8,840,476 |
| Indian State Govt. Loans. | | | |
| 1-1-46 | Cochin Govt. Loans | 2.00 | |
| 1-1-46 | Mysore Govt. Loans | 16.09 | |
| 1-1-46 | Travancore Govt. Loans | 3.50 | |
| 1-5-46 | Hyderabad Govt. Loans | 19.50 | |
| 11-11-46 | Bhopal Govt. Loans | 2.50 | |
| | Total (State Loans) | 43.59 | |

CHAPTER IV

Operation of the Security Market.

General.

1. We will now proceed to survey the mechanics of the security market—the methods by which securities are bought and sold in and outside the organised exchanges. Only then will it be possible for us to find out whether our security market has any defects, and if so, what they are, and how they arise.

2. It must be made clear at the outset that the organised security market is concerned only with dealings in securities after their issue and original sale. It may be that many members of the organised stock exchange (though not by virtue of such membership) perform certain functions which are usually discharged by issuing houses and investment bankers in other countries. It is also true that, by adopting strict listing regulations, and by insistence on certain essential requirements and conditions for the issue and original sale of securities as prerequisites for admission to dealings on their respective markets, the issue of securities by companies is indirectly influenced by the recognised exchanges of Bombay and Ahmedabad. Nevertheless, it should be noted that no stock exchange has any jurisdiction, *de jure* or otherwise, either over the issue of securities or the way in which they are initially sold. They come into the picture only when the securities come into the market for subsequent trading.

Cash Market and Forward Markets.

3. It would help us greatly to understand the operation of the security market in India, if we begin by drawing a distinction between the cash market and the forward market. Dealings may be either 'for money' ('ready delivery') or 'for the account.' In the former case, delivery of scrips and payment of price are to be made immediately or with a short period. In the latter case delivery and payment are to be made after a sufficiently long period, i.e., on the next settlement or account day. For the sake of convenience we may call the two types of transactions 'cash' and 'forward.' This distinction has an important bearing on the operation of the security market.

4. New York and Amsterdam are the principal markets abroad where the former system prevails. In New York delivery is in the 'regular way' when securities are delivered on the second full business day following the sale. But it is also possible to insist on delivery on the day of the purchase or sale, if so specified at the time of the offer. This latter is called 'cash delivery' in New York, while the same transaction on the London Stock Exchange is known as 'for money.' It is also possible in New York, in the case of bonds other than Government bonds and convertible bonds, to have 'delayed delivery,' in which case the delivery is due on the seventh day following the date of sale. (By contract, "sellers' options" are also possible lengthening the period much more, but this need not concern us here.)

5. On the London Stock Exchange, a system of forward dealings obtain, with 'term settlements.' Settlements are fortnightly, i.e., at the middle and end of each month, and the days are fixed previously. But, settlements are also monthly, in the case of certain classes of scrips, (e.g. India Securities and other securities from distant parts). When dealings are for cash, this is indicated by the words

'for money'; if nothing is said the transaction is considered to be for the account, and settlement will be made on the next settlement day. The great bulk of transactions in London, however, are forward and are settled fortnightly.

6. In Paris and Berlin term settlements as above are allowed to a lesser degree, i.e. in the case of a limited number of stocks. Trading on the Paris Exchange, it must be remembered, is dominated by Government loans, while corporate securities occupy that place in London.

7. On the comparative merits of these two types of markets there has been considerable difference of opinion. One argument favouring long-period settlement in London is that as securities from all over the world are traded there, ready delivery contracts are not practicable there. The delay and difficulty experienced in transferring registered securities in Britain is also urged in support of this system. On the other hand, bearer securities being largely in use on the continent and the U.S.A., ready delivery is more feasible in those countries. There is no doubt that term settlement facilitate an increase in the volume of trading; but they also give undue facilities for speculation. The long period allowed and the facilities for differencing and carry-over are the factors which lure people to over-speculation. No doubt this has made London brokers cautious in the selection of their clients; they look carefully to the character and credit-standing of their clients. But the temptation is too strong. "If a broker buys and the market goes against him, he may be bankrupt, but since no money settlement is made for two weeks such bankruptcy is not forced. In order to recoup his loss the broker or jobber may violently over-trade. . . . These ventures often fail and the multiplied losses break not only the speculating broker but other brokers and jobbers also." (Dice & Eiteman). Thus it is estimated that members of the London Stock Exchange failed more frequently than those in New York. According to Van Antwerp, failures in London are ten times as numerous as in New York. Perhaps it is significant that the practical Dutch, who have had the longest experience of security trade, have not established term-trading and after giving the matter considerable study definitely decided to retain their time-honoured system of cash settlement.

The Position in the Indian Stock Market.

8. In India, while the Calcutta Stock Exchange, which has the largest number of scrips on its list, has stuck—at any rate technically—to cash dealings, the Bombay and Ahmedabad Stock Exchanges have established term settlements for a limited number of scrips traded on the exchange. It may be seen from what follows that the two systems work somewhat differently in India. The other stock exchanges in India have followed either one or the other system. Some others (e.g. the unregistered exchanges in Ahmedabad) do not observe this distinction and allow forward trade in any security. The stock exchanges in India may be grouped as follows:—

(i) Exchanges permitting only cash dealings:

Calcutta Stock Exchange,
Nagpur Stock Exchange,
Delhi Stock Exchange and
Lahore Stock Exchanges (five in number).

(ii) Exchanges permitting both cash and forward dealings:

Bombay Stock Exchange,
Ahmedabad Stock Exchange,

Indian Stock Exchange (Bombay),
 Madras Stock Exchange,
 U. P. Stock Exchange (Cawnpore) and
 Bengal Share & Stock Exchange, Calcutta.

9. The stock exchanges permitting forward trading in addition to cash transactions have two lists of securities : one for cash dealings only and another for both cash and forward dealings. For the latter list, only a limited number of scrips, possessing certain prescribed qualifications, were selected. The following table will bring this out :—

| Exchange. | Number listed. | Forward List. |
|---------------------------------|----------------|---------------|
| Bombay Stock Exchange. | 288 | 34 |
| Indian Stock Exchange (Bombay) | 166 | 16 |
| Madras Stock Exchange | 327 | 19 |
| U. P. Stock Exchange (Cawnpore) | 42 | 6 |

10. When the D. I. Rule 94C was under operation, forward contracts were banned on the exchanges, and such contracts did not take place, at any rate, within the trade ring.

11. More or less similar distinctions are found also in the unorganised markets outside the stock exchanges ; they generally follow the practice of the official market nearby. Thus the 'grey' markets in Bombay and Ahmedabad permit both cash and forward dealings. The promulgation of the Defence Rule above mentioned drove out the forward trade from the organised exchanges, but they flourished in the 'grey' markets. The Katni market in Calcutta, which too grew into large dimensions during World War II, is exclusively a cash market, like the Calcutta Stock Exchange close by. The business of the Katni market is confined to the four active scrips in the clearing list of that exchange. The share bazaars in other cities, however, do not observe this distinction ; they carry on cash and forward trade as it suits them. The same is true of the private firms engaged in security trade.

The Operation of Cash Dealings.

12. As has already been shown, all stock exchanges in India as also the outside markets provide for cash dealings. The rules of the organised exchanges require that the settlement of cash transactions should be done by delivery of scrips and payment of price within a specified short period. If delivery or payment fails, the buying-in rule or selling-out rule, as the case may be, is to be applied as will be explained later. The period for delivery and payment varies from exchange to exchange and even on the same exchange the practice differs according to the class of securities.

Bombay.—13. On the recognised stock exchanges of Bombay and Ahmedabad, cash transactions are governed by precise rules. Under the Bombay Securities Contracts Control Act (1925), 'ready delivery contract' is one "for the purchase or sale of securities, for the performance of which no time is specified, and which is to be performed immediately or within a reasonable time." The question what is a reasonable time is further explained in the Act, as a question of fact in each particular case. Thus a wide latitude is given to the authorities of the exchange, in the treatment of individual cases and in the application of the buying-in and selling-out rules. Under the rules of the Bombay Stock Exchange, in the case of equities delivery is to be made not earlier than the sixth day and not later than the eighth (rule 177). In the case of Government securities, delivery and payment have to be done before 3 p.m.

on the second business day from the date of contract (rule 321). The rule also permits, if the parties specially stipulate in the contract, that delivery and payment shall not be invalid even if made on the 7th day from the date of contract. Thus seven days may be permitted under certain conditions. The position on the Ahmedabad Stock Exchange is similar to that of the Bombay Stock Exchange. On the Indian Stock Exchange, Bombay, a period of 15 days is permitted in the case of equities, for delivering the transfer forms, and 22 days for the delivery and payment of scrips. For Government securities, the delivery and payment should be made on the 2nd business day from the date of contract; but it is stipulated in the contract that it can be extended up to ten days.

Calcutta.—14. On the Calcutta Stock Exchange, delivery and payment have to be made on or after the 2nd day from the date of contract in the case of equities. In their written reply to my questionnaire, they state: "Usually deliveries fall due on the 3rd day of the transactions. Delivery on or after the due date can be enforced by the Committee." But the due date is not specifically defined and the period for which it can be further extended is not stated. Nevertheless in practice, even in the case of the 4 securities for which clearing was provided for—a small fraction of the 780 securities listed on the exchange—transactions are being settled only on the 7th day. For the rest, it is learnt that many cases of irregular deliveries are being permitted without penalty. According to reports, deliveries of scrips to non-member clients; especially in a rising market, are very irregular, owing to the absence of any definite rule. Later, deliveries have been delayed for months in many cases. We will see later how this leads to harmful consequences.

In the case of Government securities, there are two types of cash dealings on the Calcutta Stock Exchange, one for delivery and payment on the 2nd or 3rd day and the other on 'Receipt of Scrips.' In the latter case, the transaction is to be fulfilled only within 14 days.

Madras.—15. On the Madras Stock Exchange there are four types of cash dealings in equities: (a) immediate, (b) ready, (c) cash and (d) P.A.D. In the case of 'immediate' the delivery or payment is to be made on the 2nd working day from the date of contract, while in 'ready' it is to be done on the 3rd day. In the case of 'cash,' settlement is to be effected within seven days and in the case of P.A.D. within 14 days. For Government securities, cash dealings can be settled, either by cash method or by the method of specifying the delivery date in the contract. For the latter method, unlike the other exchanges no time limit is laid down.

16. As regards the other exchanges, they are found to follow one or other of the exchanges already described. In the Katni at Calcutta, where the turnover used to be the largest for the securities traded in, the practice is to close the dealings on the same day. But deliveries of scrips are not made; dealings are settled by the payment of differences in prices.

The Operation of Forward Dealings.

17. The system of term settlements has come to occupy a prominent place on the Bombay Stock Exchange and on the recognised exchange at Ahmedabad. Monthly settlements were the rule in the case of equities, and fortnightly settlements in the case of Government securities. The same was true also of the curb markets. The

Morison Committee had recommended fortnightly settlements, but the authorities of the two recognised stock exchanges turned a deaf ear to this recommendation. When forward dealings were prohibited in war-time as pointed out above, it only drove forward dealings from the trade ring of the organised exchanges to outside markets. With the lapse of this Defence Rule, exchanges have revived their future dealings. The Bombay Stock Exchange has given up its monthly settlements in equity transactions, and have adopted fortnightly settlements.

18. Briefly the operation of forward transactions is as follows:— When the dealings are 'for the account' the contracts are to be fulfilled only on the settling day for which they are made. The settlement may be done either by delivery and payment or by ^{revert to} 'differencing' at the 'make-up' price. If any one party is unable to ^{Centre} settle by either of these two methods the contract can be 'budlied' by mutual agreement to the subsequent settlement. Settlement days for a year are prescribed, and fixed sufficiently apart to provide a long period. This long period is a vital facility for a future market. In the long period, the price may fluctuate and a dealer can take advantage to match a contract for purchase or sale, by a corresponding contract for a resale or repurchase, either to make a profit or to cut his loss. Therefore, these transactions are called 'time bargains.' Among the members the closing of the deal can be done only at the settlement on the exchange. But in transactions between a member and his client closing can be done before the settlement on the exchange, with a view to reducing the debit balance. It is these three facilities, namely, the long period, settlement by differencing, and *budla*, which lure people to indulge in excessive and unhealthy speculation.

19. We will now survey various aspects of, or stages in the conduct of trade, namely, (i) contracts; (ii) settlement and clearing; (iii) buying-in and selling-out; (iv) carry-over or budli; (v) transfer of shares; (vi) margin trading and (vii) short selling.

(i) Contracts.

20. Contract plays a prominent part in security transactions, especially in the speculative trade. As the losing parties are likely to dodge the fulfilment of transactions, it is necessary to render the agreement for transaction or bidding valid and bona fide, conferring claims or rights on both parties. Besides, any control of speculation has to start with a control of contracts.

21. On organised exchanges, the first step in a transaction, whether purchase or sale, is the contract between the parties concerned. No transaction can be recognised by an exchange without a contract in the prescribed form. This is essential whether the transaction is between member and member within the exchange or between member and non-member outside the exchange. The contract note should show the nature and terms of the transactions and should be duly stamped in accordance with the Law of Contract. A contract note given by a member-broker to a non-member client is always found to have a condition that it is subject to the rules of the exchange of which the former is a member. This practice is found prevalent even where the rules are not written and published.

22. In some cases like the Madras Stock Exchange, the rules of which are written, an additional condition that the contract is subject to the usages of the exchange is seen with a view to making the position of the member safer than that of the client. There are

4 forms of contract, either prescribed by rules or adopted by usages : (i) contracts for settlement issued by members acting for constituents as brokers ; (ii) contracts for settlement issued by members acting with constituents as principals ; (iii) ready delivery contracts, members acting as brokers ; and (iv) ready delivery contracts, members acting as principals. In the latter three cases, whether between members or between members and non-members, brokerage, an important factor adding to the price, is never separately mentioned. Thus a knowledge of the brokerage added to the price, is denied to the public, as well as the authorities of the exchanges. Yet, such contracts are found officially prescribed even by exchanges whose rules are approved by a Provincial Government. In practice, contracts between members, on exchanges, whether by usages or by rules (as in Madras), are always done as principals. Besides, contracts in genuine form are never passed between members. 'Memos' or 'notes' are substituted for formal contracts and the practice is recognised by every exchange. Such methods are adopted only to circumvent the rules regarding contract stamps. Concerned about the loss of revenue, the Bombay Government issued a notification directing that even the memos should be stamped *ad valorem* in accordance with the Contracts Act. But, the action does not appear to have been successful. As matters stand, genuine contracts duly stamped, are being passed only between members and their clients outside the stock exchange. Nevertheless, on two recognised stock exchanges of Bombay Province, for transactions passing through their Clearing Houses, the presidents used to help the Government in getting the stamp duties. It is doubtful if this service was rendered fully after the promulgation of D. I. Rule 94C. Thus almost all the transactions between members on stock exchanges and the entire volume of transaction on the curbs, are being done without proper contracts duly stamped.

(ii) Settlement and Clearance.

23. Contracts, whether for cash or for the account, are fulfilled through settlement. The mode of settlement has an important bearing on the regulation of stock dealings. Settlement within time limits is essential to prevent accumulation of liabilities of dealers. If liabilities are allowed to accumulate dealers may find it difficult to discharge them later and thus may lead the market to a crisis. Settlement is to be made in some exchanges according to written rules, and in others according to rules and usages. In curb exchanges and unorganised share bazaars, there are only a few unwritten rules for this purpose. We have seen that the contracts between members and non-member clients are subject to the rules or usages of the exchange to which the former are attached. Hence the settlement between them too ought to be done according to the practice on the exchanges.

24. The way of settlement and the facilities afforded for the purpose are the most important factors which regulate the speculative activities of the members as well as the public. For example, if members are to take or make delivery in a short period of all their purchases or sales, large funds will be required and this may deter them from doing too many transactions. Whereas, if they are allowed to settle the bargains by some device, without taking or making delivery or full payment, it will encourage them to do excessive speculation. Similarly, if compromise between defaulters and creditors is permitted it is bound to encourage much undesirable speculation.

25. The arrangements and the procedure for settlement are found

to vary among the exchanges. On some exchanges like the Native Stock and Share Brokers' Association, transactions in some securities are to be settled through the agency of the exchange, while the rest are to be settled only with the knowledge of the exchange. On the Calcutta Stock Exchange, though a portion of the transactions are settled through the agency, the rest are fulfilled independently of the machinery and knowledge of the exchange. On others like that of Madras, the entire settlement is done independently of the machinery and knowledge of the exchanges. In the latter two cases, an exchange is only to intervene and enforce remedial measures in accordance with the rules of delivery and payment when failure is reported. Where the transactions are settled through the agency, the exchange has provided a clearing house. Of the 21 exchanges in the country only three are now provided with clearing houses—the Bombay Stock Exchange from 1921, Ahmedabad Share Brokers' Association from 1925, and Indian Stock Exchange (Bombay) from 1937. The Calcutta Stock Exchange had made arrangements for clearing 4 or 5 securities from 1944 December, but this arrangement was discontinued in 1946. Even on the three exchanges, clearing is limited to a very few active counters as shown in para 9. Clearing arrangements in Calcutta have since been discontinued.

As the mode of settlement differs with the nature of the market, the subject may be dealt with separately under cash and forward markets.

Settlement of Cash Dealings.

26. Ready Delivery Contracts enjoin that the parties should take or make delivery of the securities bought or sold, against payment. Settlement in any other way, according to the rules of the exchanges, is not permitted. If any one party fails either to make or take delivery, the securities will be bought-in or sold-out in the open market by the Secretary of the Exchange and the loss will be realised. In stock exchanges served by clearing houses, the securities in the cash list are divided into two groups, one group for settlement through the clearing house and the other for settlement by a process of 'hand delivery.' In the case of the former, i.e., securities which are cleared, members are to submit to the clearing house one day before the 'delivery day' a statement in prescribed form stating their purchases and sales classified according to the securities. On the 'clearing day' members are to deliver scrips for the balance sale, after crossing out purchases and sales, along with the payment for the debit balance, if any, in the account. On the day after the clearance day, securities will be delivered to the purchasing members by the clearing house and payment to the selling members will be credited to their accounts. If any member is found to fail either to make or take delivery, the securities will be bought-in or sold-out against him, as the case may be, in the open market by the secretary of the exchange. The damages from such a procedure will be realised later from the defaulter. However, since the promulgation of D. I. Rule 94C, a new practice has come into vogue in the Bombay and Ahmedabad Exchanges in the settlement of contracts regarding cleared securities. A delivery rate for each security will be fixed by the exchange on the clearance day; and members are permitted to settle their contracts by the adjustment of accounts and payment of differences in prices. Thus, it has been made possible to effect settlements without the delivery of scrips and full payment of prices.

27. The settlement of contracts in the case of non-cleared securities is effected through a process of 'hand delivery,' i.e. between the members themselves without the intervention of the clearing house. In the recognised exchanges of Bombay and Ahmedabad, though the settlement is through hand delivery it comes under the knowledge of the exchange. If delivery tickets are not delivered at the purchaser's office before 3 p.m. on the day fixed for it, the tickets are to be delivered to the purchasers in the settling room of the exchange in the presence of an officer of the exchange. If any purchaser is absent or found to refuse acceptance, the officer is to endorse such tickets. Similarly, if any seller is absent or found to refuse the delivery of the tickets, the buyer may get the 'memo' from the former endorsed by the officer. In case of absence of either party, the seller is permitted to deliver the tickets to the purchaser's office later. In the case of refusal either of delivery or of an acceptance, the securities will be bought-in or sold-out, as the case may be, in accordance with the rules of delivery and payment. Similarly, on the settlement day, the delivery of shares with transfer forms and payments are to be made in the settling room where an officer will be present. If any failure either to delivery or to accept is reported, the securities will be bought-in or sold-out as the case may be in accordance with the Rules. Thus the settlement comes into the knowledge of the exchange.

28. On the Calcutta Stock Exchange, however, the settlement of contracts in the case of non-cleared securities is not done under the supervision of the exchange; nor does it come to the knowledge of the exchange. Selling members are to settle their transactions by delivering the scrips to the purchasing members' offices against payment. Only if a failure is reported, the exchange is to intervene with remedial measures in accordance with the rules. As already mentioned, the usual practice is to deliver the securities on the 3rd day; and yet, the delivery on the 3rd day cannot be insisted on as the contracts contain a clause, "that delivery shall be made on or after the 2nd day." The time that can be extended after the 2nd day has not been specifically defined. In practice, however, as in the case of cleared securities, members are found to wait for the delivery for a week. In case of failure either to delivery or accept the securities even after a week, the matter may be reported to the exchange for remedial action. But even for such complaints or reports for remedial action, no time limit is found either in the rules or in the practice of the exchange. Many instances have been noticed where the exchange has accepted complaints or reports for remedial action weeks after the dates of contracts. (Many such cases are said to be pending in the Calcutta High Court against the Exchange). However, if failure is one of acceptance, the Exchange, after due notice to the party concerned, may sell-out the securities in the open market against the defaulter in accordance with the practice. But if the failure is one of delivery the procedure has been found cumbersome and remedial action by buying-in used to be delayed for a long time. Several instances have been noticed where remedial action has been taken months after contract dates.

29. As regards the settlement on other exchanges, two of them, namely, the Lahore Stock Exchange and the All-India Stock Exchange are found to follow the system for non-cleared securities on Calcutta Stock Exchange. Three exchanges under C group in Ahmedabad have no defined rules or settled conventions for the fulfilment of contracts. In practice, however, they are found to settle most of the transactions weekly, more by the payment of 'differences' than by actual delivery.

of scrips. Though the settling rate is fixed by the exchange, the settlement is done only independently of the machinery and knowledge of exchange. On other exchanges like that of Madras, though the settlement is done only independently of the machinery and knowledge of the exchange, the period for settlement is clearly defined and delivery of scrips and payments for them are compulsory. Also if a failure is reported, remedial action by buying-in or selling-out, as the case may be, is to be taken in a specified period.

Settlement of Forward Contracts.

30. Both equities and Government securities are admitted for forward trade, and on every exchange contracts for transactions in the former are to be fulfilled monthly and in the latter fortnightly. The street markets also follow the same practice. The mode of settlement too is the same. The settlement dates in an year for either class of securities are fixed in advance, before the commencement of the year. Legally, every contract enjoins that delivery should be made and paid for, on the dates fixed for the purpose. Yet in practice, settlement by making or taking delivery in forward contracts is very seldom done. Such transactions are taken up by speculators with a view to making profit out of time-bargains from purchases and sales during the course of the settling period. During every settlement, the period being long, there will be a number of contracts for purchases and sales between members. These contracts are crossed out on the last day and only the remaining are to be settled finally by one of the ways permitted by the exchange. It has already been mentioned that three ways are provided, namely, (1) by delivery and payment, (2) by the reversal of contract and payment of differences in prices based on the make-up price, (3) by carrying-over or budlying to the next settlement. If any one party is not willing to square up by the latter two methods, the securities are to be delivered and paid for on the delivery day. Then, if any party fails either to make or take delivery, the securities will be bought-in or sold-out against him in the open market and damages will be realised. However, settlement by the method of making and taking delivery is done only on Madras Stock Exchange. On other exchanges forward contracts are generally settled only by the latter two methods with a view to avoiding delivery of scrips or payment of full price which would involve large amounts of money or credit. For this, a day before the delivery day, for every security the making-up price for settlement, and the budla rates for carry-over are fixed by the Managing Committee of the exchange after due consideration of the market trends and the technical position in purchases and sales. The outstanding transactions after the elimination of the crossed-out contracts are then settled either by the reversal of contracts and payment of differences in prices based on the make-up price on the pay day, or are carried over to the next settlement by the payment of the budla charge. If any member fails to fulfil his contracts either by the payment of differences or by carry-over before noon on the settling day, he will be declared a defaulter. Immediately after such declaration the managing committee will fix a 'hammer price' on each security and all members having contracts with the defaulter are to close their transactions either by selling or buying the securities to or from him, as the case may be, at the hammer price. But payments are to be claimed from the Defaulters' Committee to whom the defaulter is to surrender all his assets and liabilities. Thereafter the member will be suspended from further trading on the stock exchange.

On an exchange where there is a clearing house, all forward contracts are to be settled through the clearing house. On others, the settlement is done between the members themselves and only failures are reported to the exchange for remedial action.

(iii) Buying-in and Selling-out.

32. We have seen above that when a member does not tender or accept 'delivery,' the shares are either bought-in or sold-out, as the case may be, on his account in the open market by the Stock Exchange and damages realised from him. These two are important functions of an organised exchange, and power for this is vested in its governing board. The object of these two rules is mainly to enforce the fulfilment of the contracts when a member does not discharge them voluntarily in accordance with the rules. Their rigorous enforcement may also deter members from over-trading and regulate his speculative activities. The timely enforcement of these rules is also essential in the interests of equity in the relations between members. If some members postpone making or taking 'delivery' till conditions turn favourable to them, it is bound to lead to capital depreciation and loss for other members as well as for investors. Therefore, these rules are essential for the orderly conduct of business in stock exchanges.

33. Yet the enforcement under abnormal circumstances may produce the contrary effect. For example, in an 'over-sold' market under a corner, if the buying-in is permitted the short sellers may be seriously affected and even ruined, thus producing a crisis in the entire market. Similarly in an over-bought position under a bear-raid, if selling-out is adopted the 'bulls' are bound to suffer severely.

34. Now we will see how these operations are being conducted in the different Stock Exchanges. In the recognized stock exchanges of Bombay and Ahmedabad, failure to fulfil the transactions is to be reported immediately. The buying-in or selling-out should be done on the day following the day of failure and no notice to the party concerned is necessary. Nevertheless, the Governing Board is empowered to extend the time up to 15 days beyond which the right cannot be exercised and the Board is not competent to vary this rule. Also, when an over-sold position under a corner is there or is likely to arise, the rule of buying-in may be suspended for 24 hours after which an extension can only be made subject to the sanction of Government. But, in an over-bought position under a 'bear raid' the rules of selling-out cannot be suspended in these two exchanges. In the Indian Stock Exchange, Bombay, although the rules are similar, notice to the party is necessary and the Board is competent to vary the rules according to their discretion. In the Madras Stock Exchange, the failure need be reported only within one month and thereafter a period of 15 days is granted for the operation of buying-in or selling-out. The Board is also found to possess absolute powers to vary the rules according to its discretion. Besides, there are no defined rules in regard to the suspension of buying-in or selling-out under abnormal conditions, though the Board can do it under power of 'objects' in the Memorandum of Association of the Company.

35. The position in the Calcutta Stock Exchange is not quite definite. The rules regarding such important operations, which should control over-trading by members, are not even defined. Neither any time-limit nor any definite procedure is laid down in the bye-laws, nor observed in practice. This Exchange has been found to accept reports of failure and application for action even weeks or months

the exchange), the failures at present are being reported weekly, though the buying-in or selling-out is often delayed. The position in regard to the suspension under corner or 'bear raid' is similar to that of Madras.

36. The U. P. Stock Exchange has a defined procedure and almost follows the system in vogue at the Bombay Stock Exchange. In addition, this Exchange has a rule by which the selling-out operation in an over-sold market under a bear-raid can be suspended so as to provide protection to the Bulls. As regards the other established exchanges, although they have precisely defined rules for the fulfilment of the contracts, some of them habitually delay the remedial actions of buying-in and selling-out. For the suspension of the rule under abnormal conditions, their powers and practice too are similar to those of Madras and Calcutta. In the C group of exchanges these rules are very seldom adopted.

(iv) Budli or Carry-over.

37. We have seen that forward contracts can be settled in some exchanges by budli or carry-over. This is done when parties, whether members or their clients, are unable or unwilling to fulfil the transactions by other methods. It generally happens when prices do not move according to the expectations of the parties concerned. Settlement by this method, in fact, is not a fulfilment of the bargains. It is only a closure of the contract for the particular settlement for which it has been made. The obligation to make or take delivery on the existing terms is only postponed and continued up to the next settlement through a new contract. For, when such new contract is between a member and his client, a concession in the brokerage too is permitted. The brokerage for a budla contract is usually $\frac{1}{4}$ th of that mentioned in the schedule of minimum brokerage. But, for the act of postponement of 'delivery' or payment, the party who wants the obligation is to make a payment to the other, known as the 'budla charge' fixed by the exchange in proportion to the fluctuations in price after due consideration of the market trends and the technical position of purchases and sales. But if the prices remain static, carry-over is done only on even terms, i.e., without payment of a budla charge.

38. In practice, budla at present is being done in two ways. (i) by parties accommodating each other, (ii) through an intermediary known as Budlivala who lends money or security, as the case may be.

(v) Parties Accommodating Each Other.

39. Here budli is done by means of two new contracts. A purchase or a bull transaction is carried over by a corresponding sale for the current settlement at the 'making-up' price and a re-purchase for the next settlement. At the re-purchase, either the budla charge may be paid separately or may be added to or deducted from, the price. Similarly, a sale or a bear transaction is carried over by a corresponding purchase at the 'making-up' price, and a resale for the next settlement. In the resale, as in the first case, the budla charge may be paid separately or may be added to, or subtracted from, the price. Thus the original contract in either case is settled in equity, but the fulfilment of the bargain is postponed for the next settlement.

ment, by the other. In the 'bull' transaction the 'bear' is extending a credit to the bull for an agreed interest, called budla charge, or budligala or contango, ~~fixed by the exchange~~. In the 'bear' transaction, it is a lending of shares by the bull to the bear for the budla charge or backwardation. The rate of budla charge, whether contango or backwardation, is generally ruled by the technical position in purchases and sales. In a heavily over-bought market the contango will be very high as it creates scarce money conditions in the market. In a heavily 'bear-sold' market, though money condition is easy, the backwardation charge will be high due to scarcity of scrips.

(b) Budli through an Intermediary or Budlivala.

40. We have seen that budli is done by a Bull, because he is either unable due to 'over-bought' position, or unwilling to pay and take delivery at the settlement for which he has contracted to purchase. Thus he is in need of a loan or wants someone to take delivery for him. Similarly a bear who has 'short-sold' in the market is in need of a loan of securities or wants someone to deliver the securities for him at the settlement. To help these operators there are a number of rich budlivalas both inside the stock exchange among the members and outside among the non-members, who conduct the business of lending money as well as securities for the purpose of settlement. The party who wants the money, or the security as the case may be, is to make a contract with the budlivala for a time loan undertaking the return of the loan at the expiry of the period. The period usually is the period of settlement on the stock exchange. ~~The rate of interest is charged per share, whether the loan is money to take delivery, or securities to make delivery. The interest is fixed according to the budla charge and may be slightly less than that to attract customers.~~ The bull is to deposit the securities he takes delivery of with Budlivala against the loan and the Bear is to deposit the money he has received on making the delivery against the loan of securities, which will be returned to them on their respective returns of their loans. But neither the Budlivala nor the Bear is bound to return the identical securities, each party is to return only the same amount of securities. Here, though the original transaction between the members is settled on the exchange, it is simultaneously opened up for the next settlement with the Budlivala. Thus in fact it is only a postponement of the fulfilment or budli of the original bargains to the next settlement.

41. By the second method budla can be done even in cash market operations and the system is widely prevalent in Calcutta.

(V) Transfer of Securities.

42. Stock exchanges, stock dealers, and speculators are greatly concerned about the mode and procedure of the transfer of ownership of securities. In fact, the extent of speculative dealings is directly related to the facility for transfer. Easy and quick, but safe, transfer of ownership is an essential requisite for speculative trade in securities. Dealings on the market are done in quick succession to take advantage of the fluctuations in price. Purchase and sale and repurchase and resale are often done several times even in the course of a few hours. In cash dealings we have seen that the maximum time for delivery on a stock exchange is one week. Thus even if dealings are done strictly

in accordance with the rules, a particular set of scrips may have a chance of changing ownership nearly 46 times a year, as there are 46 deliveries in a year. On exchanges like that of Calcutta where the ready delivery is to be done in two days, the scrips may change ownership more than 150 times in a year. But this can be managed only if facilities for quick and safe transfer of ownership are provided with. Thus, the mode and procedure of transfer has a great influence over the regulation of speculative trade in securities.

43. Transfer of securities whether of Government or of companies is governed by statutory laws. According to the method of transfer, securities are of three classes—(a) Bearer Bonds and Shares, (b) Inscribed Stock, and (c) Registered Stock and Shares. The ownership of Bearer Bonds and Shares is transferable by mere delivery from hand to hand and no other transfer formalities are to be complied with. The bearer is the owner and he is entitled to get the dividend or interest. Dividend coupons are attached to this sort of securities and are only to be cut out and presented to the paying office for the payment. In India such securities are few and despite their high negotiability are not popular on the stock exchanges as fraudulent transactions are easy in the case of them. Though inscribed Stock is the safest for investment, its negotiability is the least. Here, actual certificates conferring title on the owners are not given; but their names and the amount of stock they hold are inscribed in a statutory register, kept for the purpose in the office of the issuing body. Inscribed stock can be transferred only by declaring and signing in the register by the owner showing that he has assigned his holdings in favour of another. For this, the transferor is to be identified at the transfer office and his signature in the register should be witnessed. The transferee too is to be introduced and identified to the office and sign the Acceptance of the stock. However, as this sort of security has the least negotiability they are not taken on the stock market for speculative dealings.

44. Registered stocks, and shares are the securities mostly dealt in on the stock exchanges. As their name signifies, they are registered in the share or stock register of the company or the Government that has issued them. The law, i.e., the Indian Companies Act, or the Indian Securities Act, as the case may be, imposes upon the issuing body, whether a corporation or a Government, the duty of keeping books or record and that of making transfers of stock when requests are received therefor. Almost all the joint stock companies have their capital only in the form of registered stock or shares. A considerable part of the public debt or Government loans too is in the form of registered stock. However, the certificates or scrips issued by a company or a Government under its seal is not a title deed in itself, but is only a statement showing the registered holder's name and the extent of his holding. From the point of view of the company or the Government, the change of ownership, therefore, cannot be effected by a holder by a mere assigning of the scrip in favour of another; but can be done only by transfer and registration in the company's or Government's books. For the transfer, a regular transfer deed duly signed by both the transferor and the transferee and witnessed, must be passed along with the scrips from the transferor to the transferee. The deed is to be stamped with an *ad valorem* stamp in accordance with the law, except in certain exempted Government securities. Then the transfer deed along with the scrips are to be lodged with the company or the Government, as the case may be, for transfer and registration in the register kept for the purpose, after which new scrips

are issued to the transferee in his name. In the case of joint stock company securities, prior to 1936, there was no uniform and definite procedure in transfer. The method and procedure of transfer was left to the company to incorporate in its Articles of Association. As this practice has raised much protests and clamour from the shareholders as well as speculators, the Indian Companies Act was amended in 1936, laying down a uniform and definite procedure for the transfer of securities. The amended rules as they stand today are as hereunder :

- (a) An application for the registration of the transfer of shares may be made either by the transferor or transferee.
- (b) If such application is made by the transferor in receipt of partly-paid shares the company must give notice of the application to the transferee. The company must unless objection is made by the transferee within two weeks from the date of receipt of the notice enter in the register of members the name of the transferee.
- (c) Notice to the transferee shall be deemed to have been duly given if despatched by pre-paid post to the transferee at the address given in the instrument of transfer and shall be deemed to have delivered in the ordinary course of post.
- (d) The company will register a transfer of shares or debentures only when it receives the proper instrument of transfer duly stamped and executed by the transferor and the transferee along with the scrip.
- (e) If it is proved to the satisfaction of the directors of the company that an instrument of transfer signed by the transferor or transferee has been lost the company may, if the directors think fit, on an application in writing made by the transferee and bearing the stamp required by the instrument of transfer register the transfer on such terms as to indemnity as the directors may think fit.
- (f) If a company refuses to register the transfer of any shares or debentures the company is required to send to the transferee a notice of refusal within two months from the date on which the instrument of transfer was lodged with the company.
- (g) A transfer of share or debenture or any other interest of a deceased member of company made by his legal representative, shall be as valid as if he were a member at the time of the execution of the instrument of transfer, although he is not himself a member.

Similarly, when the denomination of a scrip is for a greater number of shares while only a less number are to be transferred the procedure is the same. The company on the receipt of the necessary documents is to split the certificate according to the required number and should send the new scrips to the respective parties after the registration of their names as holders. The procedure of transfer in registered Government securities is also essentially the same.

45. Thus, the transfer of registered securities involves expenditure at every change of ownership or transaction by way of stamp duty to the Government and transfer fee to the company. Besides, to complete a transaction by transfer and registration in the company's books takes a long time, usually a month, and if there is any objection, transfer may take several months. The procedure, therefore, involves not only expenditure, but it reduces the negotiability of the securities considerably. If 'settlement' can be completed only by transfer in

the company's books, transactions may often be limited to 12 times a year as the law and postal facilities stand to-day. But, we have seen that dealings in the stock market are done in quick succession and are settled as many as 150 times in certain securities on some exchanges and in all securities in certain exchanges. This negotiability is imparted to a registered security only by the recognition and use of Blank Transfer as valid delivery for settlement.

46. **Blank Transfer.**—In a regular transfer deed we have seen that the seller and the buyer should fill in their names and signatures, and the deed should be duly witnessed and dated. When such a regular deed is executed the buyer cannot obtain a right to sell the security again, without transfer and registration in the books of the company. To overcome this difficulty, in practice the seller gives only a 'blank' transfer to the buyer. In the blank transfer deed the seller only fills in his name and signature. Neither the buyer's name and signature nor the *date of sale* are filled in the transfer form. The advantage in giving such a blank deed is that the buyer will be at liberty ~~either~~ to sell it again without filling his name and signature to a subsequent buyer. In the latter case he can avoid the payment for the transfer stamp and new deed to the buyer. The process of purchase and sale can be repeated any number of times with the blank deed and ultimately when it reaches the hands of one who wants to retain the shares he can fill in his name and date and get it registered in the company's books. For this ultimate transfer and registration the first seller will be treated as the transferor even if it happens years after his death. On such registration the last buyer will be recognised as a shareholder by the company and the other intervening parties being not such shareholders, but only having had an equitable right in themselves if they had so desired to be registered as shareholders of the company. Besides, Blank Transfer serves to pledge the shares as a security to get loans from Banks. In the absence of Blank Transfer the borrower will have to execute a transfer deed in favour of the Bank to make the shares a valid security for the loan. It also helps to get credit in the form of shares as well as money for 'carry-over' or budli. It is the most common method for share transfer in speculative dealings in this country. On every stock exchange, Blank Transfer is not only recognised as a valid delivery, but that alone is accepted for delivery at settlement. In short, Blank Transfer helps speculation in four ways :—

- (1) It imparts a high degree of negotiability to the security along with safety for dealings and enables the share dealers and speculators to do any number of transactions without transfer and registration for any length of time ;
- (2) it lightens the burden of transfer by avoiding payment of stamp duty ;
- (3) it helps to procure loans for further speculation ;
- (4) it facilitates budli.

(vi) Margin Trading.

47. In the foregoing sections of this chapter, various facilities for speculation have been dealt with, namely, long period settlement in forward trade, settlement by payment of differences, budli, blank transfer, etc. These are all available to members of stock exchange as well as to the public. We may now consider certain other facilities which lure outsiders to speculation. Accommodation for 'margin'

trading' is one such. It is a credit facility extended by brokers and banks to those who have no funds of their own for share dealings. It is important, as it is alleged to be a prime market, often leading to crises and the failure of stock exchange members. Further, in regard to the facilities mentioned above, exchanges exercise some supervision, directly or indirectly, but there is no such supervision or control in regard to margin dealings. It is entirely left to the discretion of the members, and exchanges in this country do not intervene to regulate this particular relationship between a member and his clients or between a member and a bank granting him credit.

48. Margin trading is widely prevalent in almost all the stock exchanges in the country. In fact, a very large proportion of the total business of the exchanges consists of margin transactions. Margin trading is not confined to, or specially connected with, forward dealings; on the other hand, margin trading is more prevalent in the cash market. In New York Stock Exchange there is no forward market, but margin trading is the most common practice there and comprehensive legislation has been carried out for regulating it. Similarly, Calcutta Stock Exchange is to be classed as an exclusively cash market; yet margin trading is widely prevalent there.

49. Trading on margin implies trading on account, but it is different from trading on account for settlement of contracts—i.e. forward trade. We have seen that in forward trade, contracts for transactions are entered into with a view to setting off purchases by sales or vice versa, during a definite period and the balance only paid on the settlement day by any of the methods described under the settlement of future contracts. But, if the delivery is to be taken and if the customer has no funds, there too the method of margin transaction may be adopted for the purpose of settlement with the broker. But this accounting is different. In margin trade the transaction is completed with borrowed money or scrips as the case may be. It is a credit transaction, whereby credit is extended to a client by a broker when the former has no funds of his own to speculate in the stock market. In such a transaction the client pays only part of the price and the broker will pay the balance and take delivery of the securities which will be held by the broker himself as a pledge against the loan. The part payment the client makes to the broker is known as the 'margin' or 'equity.' It may be paid either in cash or securities or both. For the margin transaction the client is to open an account with his broker. In the account his margin deposit is credited, resulting in a net debit balance equal to the loan. This debit balance is secured only by the collateral—i.e. the securities taken delivery of and kept as the pledge, whose market price is then in excess of the loan by the amount of margin deposited with the broker. If the prices remain static or if they fluctuate only in favour of the client the margin deposited is sufficient to protect the loan advanced by the Broker. But if the prices move against the client, the value of the collateral will fall and the protection provided by the initial margin will dissipate. To protect the Broker against such a contingency the client is usually to give an agreement to the former, underaking to maintain an agreed margin. It is to be done by supplementing the initial margin deposit from time to time by additional margin equal to the amount of fall in price, to provide with the same degree of protection as has been provided with at the outset. But if the prices move up as in a bull market in favour of the client, the value of the margin will automatically increase and on the same margin deposit the client may speculate further by additional purchases.

50. Thus in a bull market the margin deposit remaining the same, the volume of speculation usually will increase and the increasing purchases will raise the price further, drawing more and more credit into the market to meet both the increased volume of purchase and the increased price. The vicious circle often works up to a point, where the short sellers may be squeezed in the event of a corner or may result in an intensive 'bear raid' bringing down the price precipitously. In either case the evil is apparent. In the former case the bears may fail and in the latter the purchasing clients will have to find more margin and their brokers more credit to fulfil their contracts. In the latter case the inability to find more credit may lead to their failure and the market to a crisis exposing the credit they have already received from Banks to risk and dissipation. Thus, margin trade increases speculation in both ways and if not strictly controlled it is always likely not only to create crisis in the stock market but may beget trouble even in the money market.

51. The margin may be viewed from two angles. It may be regarded as the ratio between the client's equity and the value of the collateral or as the ratio between the equity and the amount of the loan, i.e., in brokerage accounting, the debit balance. It may be figured in points or percentage or both. However, prices in stock market always being dynamic the value of margin too varies. A flat margin therefore cannot afford safety to the credit involved in transactions. The requirements of equity should necessarily be flexible and regulated, not only to protect the credit already involved in the transaction, but also to prevent the client from over-trading, involving more and more credit in a vicious circle of operations. Usually the credit is not entirely supplied by the broker; he may have many clients doing margin trade and his resources may be inadequate to finance all. In practice, he may advance sometimes part of the capital and the rest is obtained from banks with which the securities taken delivery of are hypothecated as collateral for the loan. Besides, clients are not the only margin operators in the market requiring credit. As there is no functional classification among the members of the Indian stock exchanges, brokers themselves are agents as well as dealers. Brokers also usually do margin transactions when they trade on their own account with credit obtained from Banks or other financiers. But there is one difference between the margin transaction of a client and that of a broker. The broker does not give an undertaking to maintain a percentage (or flexible) margin to a Bank that supplies him the credit. The Bank usually deducts a suitable flat margin from the market price of the securities under hypothecation before granting the credit. Thus, a very large volume of short term credit is required and involved in margin transactions.

Short-selling

52. Short sale, as defined by the Securities Exchange Commission, is "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." Its purpose generally is to take advantage of an anticipated decline in the market price of a security. The short seller hopes to 'cover' by the purchase at a lower price thus making a profit. But, if after the short sale the security rises in prices, the short seller has to 'cover' by purchase at a price higher than the sale price and thus will have to incur a loss. Like margin dealings,

short selling is a form of speculation, but while the margin dealer hopes to gain through a rise in prices, the short seller counts on gaining by fall in prices.

53. Short selling like other forms of speculation fulfils a legitimate purpose. When there is too great a rise in prices, short selling tends to restrain it; conversely the covering of short sales tends to keep prices from going down too fast and too far, and thus 'cushions' the fall. On these and other grounds, the "Twentieth Century Fund" analysis of security markets recommends that no general prohibition need be placed upon the practice of short selling. "One of the most essential functions of organised markets is to reflect the competent opinions of all competing interests. To admit only opinion looking to higher prices is to provide a one side market. To bring together an open expression of both long and short opinions is to provide a two sided market and if properly done, better reflection of prevailing conditions will be shown in the price structure."

54. Short selling, however, is not without defects. Excessive short selling gives rise to corners. A 'corner' arises when more shares than are available for delivery on the day of settlement have been sold and the buyer holds the sellers to ransom, i.e., as the shares come to be held by an individual or a syndicate, the short seller will have to buy the shares at prices dictated to him by those who corner. Analysis of the Wall Street Crash of 1929 by American statisticians has shown that short sales did not actually provide the two advantages claimed for them, i.e., restraint on rising prices and cushioning price fall. Moreover, there has always been an inherent opposition to people selling what they do not possess, and although the advantage of forward sales in commodity markets has long been recognised, similar advantages have not been conceded for short sales in the security market.

55. From early days, efforts have been made at controlling, even prohibiting, short sales. For instance, in England, Burnard's Act (1773) prohibited short sales altogether and a similar prohibition was attempted in Germany in 1896. But both these attempts were later abandoned, in England in 1860 and in Germany in 1909. In the U.S.A. the wiser course of regulating short sales has been attempted and in this respect the practice of the New York Stock Exchange is notable. The object of regulation has been chiefly to prevent 'bear-raids.' In 1935, the exchanges in America adopted the following rule on the recommendation of the Securities Exchange Commission. "No member shall use any facility of the exchange to effect on the exchange a short sale of any security in the unit of trading at a price below the last 'regular way' the sale price of such security on the exchange."

56. It has been generally found necessary to suspend short-selling for limited periods to protect the interest of short sellers and of the public. In New York short sales were entirely suspended in September, 1931 when the U. K. went off the gold standard, but the suspension remained only for two days. The Bombay Stock Exchange has made provision in its regulations to make a temporary suspension of short selling in the public interest, but such suspension can be effective only for 24 hours, and for any longer period, only with the previous consent of the Government. The Atlay Committee however took the stringent view that short sellers should be left to pay the penalty in the absence of any fraud and recommended the London Stock Exchange practice, namely, that all contracts entered into for the sale or purchase of shares must be fulfilled by the delivery of shares or by the payment of the purchase price. And if he who has sold ~~again~~ cannot

on the day of settlement, ^{deliver} the shares which he has sold, he must submit to the ordinary procedure of the exchange whereby the shares are bought in against him in open market, unless he can prove to the complete satisfaction of the Committee that he has been the victim of fraud. The Morison Committee, however, recognised the need for protecting the sellers and thus recommended the view that the Board should be permitted to suspend the buying-in rule, so that the buyer may not utilise the machinery of the stock exchange to drive prices to ~~an~~ altogether ~~an~~ unwarranted heights. Provision for this was then made in the rules of the Bombay Stock Exchange.

CHAPTER V.

THE SECURITY MARKET AS IT SHOULD BE.

We have in the previous chapters dealt with the constitution, management and technique of the stock market in India. It is now possible to enquire into the alleged defects of the stock market as it now functions, and to see how they affect the interests of the public and of the national economy as a whole. Only then can we be in a position to judge if the demand lately made for Government regulation is justified. It will then be for us to see what kind of regulation may be necessary to enable the stock market to fulfil its proper functions.

Raison d'être of the Security Market.

2. At the outset, it is necessary to clarify what those purposes are which the stock market has to carry out. In other words, what is its *raison d'être*? This has become necessary, especially because there are many persons who think that this institution has no legitimate purpose to fulfil. Not only a drastic reform, but even the total abolition of the stock exchanges has been advocated in recent years. Resolutions have been repeatedly put forward by influential members of the Indian Legislative Assembly demanding the abolition of all stock exchanges.

3. The stock market is an essential concomitant of the capitalistic system of economy, at any rate, of that form of capitalistic system at which most countries have now arrived. Corporate enterprise is essential for the proper functioning of this system; it brings together large masses of capital necessary for the economic development of a country. Although the first accumulation of capital in joint stock companies is done chiefly by underwriting firms, investment bankers, etc., it is chiefly the stock market that carries out the redistribution of these securities, which is also an essential function. The presence of stock exchanges where securities can be sold produces an interest in the securities on the part of the public. In other words, the stock market gives mobility to property represented by stocks and bonds. It is true that most of the trade on the stock exchanges is of a short-term character and highly speculative, but such transactions can help in the flow of long-term capital into the most fruitful channels. A well-regulated security market can also serve as a barometer of general business conditions and could indicate, by price movements, the economic prospects of the different industries in the country. It also helps investments abroad and facilitates international payments without shipping gold.

4. Similarly, the stock market is necessary for the raising and management of the public debt, which is important especially in countries like India where economic development in many fields is in the hands of public authorities (Central Government, Provincial Governments, Municipalities, Port Trusts, etc.).

5. A stock market is therefore bound to arise wherever corporate capitalism is functioning. Whether there is an organised market or not, certificates representing Government loans and shares of ownership of corporate capital will be bought and sold. If this market is properly organised, it will serve its purpose well, and exert beneficent reactions on the national economy as well; if, on the other hand, it is neglected, mischievous manipulators will use it for their selfish ends, to the serious detriment of public interest. The abolition

of stock exchanges will not therefore solve the problem ; it will only make matters worse. Trade in securities will in any case go on, and unbridled speculation may arise causing serious risks to financial security.

6. Especially when a country is launching on a plan of industrial development, a healthy securities market must be considered as a necessary adjunct. Industrialisation involves large scale investment. Capital for such investment, if raised at home, must come from the savings of a large number of persons. If investment is made risky by too wide fluctuations in share prices, savings would go into safer investments like land and gold hoardings. This has long been one of the causes why investments in industry are scanty in India, although annual savings have not been too small. The jugglery of company promoters and the manipulations of share dealers have undermined to some extent the incentive for investment. But with well-organised stock exchanges working in a regulated manner, much more of the annual savings can be made to flow into industry and business.

FUNCTIONS OF A SECURITY MARKET.

7. We will now see how the security market helps in encouraging investment. The following functions can be discharged by a security market, if it is properly conducted :—

- (1) It gives securities sufficient marketability and price continuity necessary to serve the needs of investors.
- (2) It can set prices for securities reflecting their investment worth as closely as possible ; in other words, it can bring about a correct evaluation of securities.
- (3) It provides safety for, and equity in, dealings.
- (4) It induces, directs and allocates the flow of savings into the most productive channels.

Liquidity and Price Continuity.

8. The fundamental object of the stock market is to impart sufficient marketability to securities so that under normal conditions they can readily be bought or sold. It should enable the investor to withdraw his capital from his investments just when he requires it, with least possible loss to its value in terms of its investment worth. In other words, it should ensure convertibility or liquidity to the invested capital without significant depreciation in real values. To this end a continuous market and price stability are essential. Huebner has defined a continuous market as one, "where a security may be bought or sold during business hours at comparatively small variations from the last quoted price." For facilitating short-term investments, a ready and continuous market is necessary, and this can be achieved only through imparting negotiability to the certificates representing the invested capital. The market, therefore, should provide, (1) liquidity (2) price continuity and (3) negotiability to capital locked up in investments.

9. It must be noted, however, that the stock market is able to provide such liquidity and price continuity, only for the shares of joint stock enterprises which are accepted for trade on the stock exchange. Owing to fairly strict listing regulations, the scrips of a large number of joint stock concerns are not admitted to dealings on the stock exchange and therefore their capital is not rendered liquid nor give price continuity, and as is well-known, a large number of businesses are financed on a proprietary, partnership or private limited company

basis and even among the joint stock companies only a small number get the advantage just mentioned.

10. Nor can the stock market provide liquidity and price continuity in times of national or international crises like the two World Wars or in times of political or communal upheaval as has lately happened in this country ; for in such times there arise a general preference for liquid funds as against securities and the marketability of the latter remains only at the expense of price continuity. Thus the service rendered by the stock market is in a very limited field, but in that limited field it is real and worthwhile.

Evaluation.

11. The correct evaluation of securities is a very important function expected of an organised and regulated stock market. The market, therefore, should provide the economic machinery by which values are set upon securities. " It should produce through its continuous process of evaluation, prices for securities as close as possible to investment values, based on present and future income-yielding prospects of the various enterprises, capitalised at the natural rate of interest."

12. Such price-fixing from time to time is essential to investors as well as creditors. The investor is in need to know the worth of his holdings at any given time so as to utilise his earnings in his best interests. The creditor wants to assess the security against which he advances money or credit to his clients. But evaluation can be done only if three factors are known ; namely, (1) the net income from year to year, (2) the rate of capitalisation and (3) the ultimate break-up value or assets in the event of a winding-up of the enterprise. All these are variables and are difficult to be known at any given time. Net income cannot be measured by absolute standards and depends, among other factors, much upon managerial discretion. Besides, it may vary from year to year due to changing fortunes of business and general economic conditions. Hence, a discounting of an uncertain future trend of business risk becomes essential. The rate at which new capital can be obtained may again be different. The natural rate of interest is a complicated factor. It is a rate " which will prevail if and when all the available liquid savings are employed " into productive application. The ultimate break-up value depends on the remaining assets and general economic conditions at the time of the winding-up.

13. Yet, the price of securities should always represent as closely as possible their intrinsic worth, or a capitalised value of discounted future earnings. This can be achieved, if at all possible, to some degree of accuracy only by intelligent anticipations of many ; and here speculation and a continuous process of purchases and sales are essential. But over a wide field of investments, such evaluation and discounting of the future is not possible owing to the altogether limited scope of stock market as stated above in para. 9.

Safety for and Equity in Dealings.

14. An organised and well-managed security market is necessary to provide safety for dealings. One of the objects of the security market is " to maintain a high standard of commercial honour and integrity among its members and to promote and inculcate just and equitable principles of trade and business." With this end in view, it must work under a code of well-defined rules and regulations so as to minimise the

danger inherent in speculative dealings and manipulations which are bound to arise when a large number of speculators scramble for profits. Membership of the stock market must therefore be strictly guarded ; dealings must be regulated under definite rules and the contracts made among members and between them and customers must be enforced under the unbending authority of the governing body. In other words, for ensuring safety in dealings, an organised and well-managed security market is essential.

Direction of Savings into the Most Productive Channels.

15. Another important function which a security market could perform is to mobilise and harness capital and direct its flow into the most productive channels so as to serve in the best possible way the interests of investors and of the national economy as a whole. It serves to allocate only just enough funds for any line of industries and checks the flow of capital just when an industry begins to show a diminishing or uneconomic return.

16. Nevertheless, this function is more a result of the other three functions described in the previous paragraphs, and it is only indirectly performed by the stock market. No stock exchange directly collects any capital either for any industry or for Government. The original issue of capital is generally done either through issue houses or under-writing corporations, and it is directly subscribed to by the public whether as speculators or as investors. An exchange permits only trading in old issues when it is satisfied that the proposition is sound and the capital engaged will produce some profit.

17. But, the stock exchange provides a secondary market for the final distribution of such stocks. The issue houses, or under-writing firms or speculators initially absorb the issue only with a view to finally passing on to the hands of the investors. Such speculators undertake to shoulder the risk in the initial stage with the hope of realising a profit at a later stage. The investors subscribe only if they feel confident that they can liquidate their holdings without loss just when they require it. Thus, though the original financing usually takes place outside the organised exchanges, where the 'seasoning of securities' takes place, exchanges are essential for raising the necessary capital for productive purposes. Even an announcement that the company concerned has applied for listing on stock exchanges usually facilitates the supply of capital.

18. Sometimes a more direct method is also adopted in New York and London. In such a case the original issue is not directly offered to the public by the 'prospectus method.' The issue will be taken up entirely by syndicates or under-writing houses or Industrial Banks and subsequently it may be enlisted on an exchange and gradually passed into the hands of the investors or other speculators through trading on the exchange.

19. Whether the exchange plays a primary or secondary role, the ready and continuous market provided, the negotiability imparted to the securities and correct evaluation given to them from time to time facility for promoting liquidation of holdings without significant loss and the safety for dealings assured, makes the capital mobile and available for the purposes of investment. Even Banks and people who keep money for contingent use will not hesitate to purchase the share of companies. Thus, even through short-term investments, capital will be mobilised so as to serve long-term uses.

20. Moreover, by a process of continuous evaluation the organised market serves to determine the direction of flow of capital and allocate

funds for different lines of industries. This is achieved through the help of the price movements on the exchanges. When a rise in the price of the securities of a particular industry is permanent, it indicates that more capital can be absorbed in that line. Similarly, when the price indicates a permanent decline, it shows that no more capital can be used in such a line with advantage and the flow of capital in that line can be arrested. Thus, it discounts future business conditions and allocates funds according to the return as between industries.

SPECULATION.

Speculation has its use.

21. For discharging most of these functions, speculation is necessary. What is 'Speculation'? It has to be defined along with the allied term, 'investment.' Investment implies purchase of securities for realizing the maximum income consistent with safety, marketability and other factors. By speculation is meant trading in securities with a design to make a profit out of the changes in their market price. Cynics may say that investment is a successful speculation and speculation is an unsuccessful investment.

22. There is no doubt that speculation in stocks if properly pursued can discharge an important economic function. It has been shown above that liquidity and price continuity are essential for capital to flow freely into industry and business. But these cannot be without a large and continuous volume of transactions. A large number of buyers and sellers should be ready to trade at all times during business hours and this is only possible if there is speculation. Those interested in pure investment are necessarily few and their meagre transactions are not adequate to render the market liquid or continuous. Therefore, confining the market to investors' transactions is bound to defeat the object in view. If thus speculation is necessary for liquidity and price continuity, it is even more so for the correct evaluation of securities: Speculation helps in stabilising the price to provide price continuity which is essential for protecting the credit structure. Speculation also helps to mobilise capital and direct its flow into the most productive channels. It can also be of use in successfully discounting the future trend of business conditions. Therefore, if speculation is completely wiped out, the interest of the investors and the very object of the stock market may be frustrated.

Importance of speculation has been exaggerated.

23. But the importance of speculation has been grossly exaggerated by a host of American writers, many of whom wrote to further the interests of the stock exchanges. Their books and pamphlets have been given wide publicity by interested parties. They have been widely used in India too, especially in Bombay, for finding arguments against Government efforts at stock market regulation. The case made out for speculation on the ground that it helps to maintain liquidity and price continuity of the capital represented by stock will be readily conceded by most responsible people, but when it is assumed that a defence of speculation is also a defence of the forward market, a serious mistake is made, seeing that speculation can operate very actively in cash markets too, as has been demonstrated by the New York Stock Exchange.

Speculation in Commodities Vs. Speculation in Stock.

24. In particular, when people use the arguments justifying speculation in commodities to justify also speculation in stock, it is necessary to enter a caveat. There is indeed a clear case for a futures market in commodities like cotton and wheat which are grown in fields subject to weather conditions, which are marketed in certain seasons, which are consumed regularly and which therefore must be rationed for the benefit of consumers in times of scarcity. In the case of commodities again, the necessity for fabrication, transportation and storage makes delayed delivery necessary and thus gives a legitimate opportunity for futures transactions. Can any such justification for forward dealings be rightly claimed in stocks and shares, which do not take any time to grow or to be processed or even to be transported? A real utility arises out of hedging on the commodity exchanges which permit the processor to transfer to the speculator the risk of price changes while the goods are in process, but is there any similar function performed by futures in stocks? On the other hand, is not the manipulation of prices of entire issues, say by short-selling, a much more serious danger in the case of stock than of commodities? The fact is, the justification for any speculation in stock stands on much more slender grounds than that in commodities. But when people go further and advocate a forward market also as essential in the national interest, they have neither theory nor practice on their side.

Speculation can be misused.

25. In spite of such exaggerated claims, it must be admitted that speculation can perform a useful function, but only if conducted by well-informed and disciplined businessmen, who are equipped for correctly interpreting business conditions, so that they may be able to accurately evaluate securities at their real worth and to anticipate future investment demand safely. If, on the other hand, speculation is left to unscrupulous manipulators and ignorant 'outsiders,' violent and sudden fluctuations in prices will be caused and the result will be just the contrary of what has been stated above. Well-informed and shrewd traders skilled in forecasting prices correctly are a real aid to the security market in discharging its discounting function; and undue price fluctuations will thus be avoided. In fact, the profits made by such speculators are justified by the discounting service rendered and by the risk taken by them in buying and holding securities. But large sections of speculators even in New York and London are uninformed outsiders, with no real capacity for forecasting the future. They are generally susceptible to tips and rumours and often become the tools of professional pool operators. It is the sales and purchases of such traders that exaggerate the price movements begun by professionals. In the late twenties, such were the great majority of operators in the U. S. A. and hence the tremendous fluctuations in security prices which culminated in the stock market crash of 1929.

26. Thus speculation which, if wisely employed, can greatly help in securing the four functions of the stock market mentioned above has frequently run riot owing to the ignorance and self-regarding instincts in traders. In this way the objectives of the stock market have been defeated. Wide fluctuations in stock prices which result from unwise speculation lead to a break-down of liquidity and an erratic valuation of securities. A proper evaluation of securities must result in a comparative stability of prices as earnings from business

do not show violent variations. Therefore, wide fluctuations in stock prices must be taken as an index of the failure of the purposes for which the stock market exists.

27. Liquidity is indeed valuable, but unless price continuity is maintained to invested capital at a valuation based on investment worth, and unless at the same time safety for and equity in dealings are also provided, liquidity cannot be of any use; thus the result may be diametrically opposed to the interests of the investing public.

28. Transactions in the speculative market always take place in quick succession; often several times even in the course of an hour. And in the absence of adequate regulation, a train of evils and malpractices will follow as a result of the scramble for profits. The objective of safety for and equity in dealings will disappear, and proper evaluation and price continuity will thus be frustrated. Under such circumstances, marketability would serve only to deprive the unwary investor of his life's earnings, and would only enrich the unscrupulous speculator who has large resources for manipulation in the market.

29. But the evil will not stop there. The erratic prices resulting from speculation will not only ruin the speculators (whether members or 'outsiders'), but may also endanger the credit structure of the country. Banks are inextricably bound up with the stock market and any crash there will affect banks which invest largely in securities and advance loans based on securities as collateral. The collapse of bond prices in the U. S. A. in 1931 resulted in the banking crisis of 1933 which led to the ruin of 15,000 banks, or nearly half the number of banks of that country. Not only banks, but insurance companies and endowed benevolent institutions like schools and universities, churches and hospitals, are also affected by violent fluctuations of prices, and in this way the whole nation is affected.

30. One of the chief functions of the stock market is to direct the flow of the nation's savings into the most productive channels. This is also utterly defeated by the violent price fluctuations caused by inordinate speculation. Wrong discounting of values necessarily leads to the misdirection of the flow of capital. By breeding a hope of making easy and quick profit in the form of quick capital appreciation in a fluctuating market, without the need for waiting any long time for return after investment in real worth, much of the investible capital is diverted from productive agencies. It thus results in the concentration of capital on existing enterprises, or old issues, bringing down the yield, and taking away the attraction for industrial investment.

SECURITY MARKET AS IT SHOULD BE.

31. Therefore, speculation must be brought under control, so as to keep it within proper limits. This is what all advanced countries have done after experiencing the dire evils of uncontrolled speculation. Human nature is everywhere the same more or less. Hence the need for men willingly imposing certain controls on themselves. But India which has also experienced the worst of these evils for many years has not so far placed any effective check on speculation. Nay worse, a large section of people who have fattened on the illegitimate fruits of speculation will mean the end of economic progress!

32. How can speculation be kept within limits? This question may be answered by giving a picture of the security market as it should

be. It is not merely an ideal system, but based on the actual working of the security market at present in many advanced countries.

33. Firstly, the entire security market should be organised and regulated, not only the stock exchanges but also the outside markets in whatever form. If people are to be permitted to assemble in groups to bid and enter into speculative contracts according to a common practice, they should have an organisation to maintain such practice. Every such organisation should have a legal entity to sue and to be sued in a court of law. This is highly essential as speculative biddings are always susceptible to many fraudulent practices. Such practices are to be prevented; and fulfilment of contracts are to be enforced if parties try to opt out when they incur losses. Also, defaulters are to be sued in a court of law when they refuse to surrender their assets to answer their liabilities. Besides, all the organisations or institutions forming the market should be similar from the point of view of management and practice, though the actual proprietary rights may be vested in any body such as a voluntary association as in most countries, or as a limited liability company as in some cities of India, or as a quasi-government institution as in France and Japan.

34. All the sections of the security market should work under a code of uniform, clearly defined and fully written rules. The rules, regulations and bye-laws must cover every phase of the stock market, every type of transaction. They should be particularly aimed at providing equity to the transacting parties, whether between members, or between members and clients, or between parties through members as agents. They should give protection not only to the members, but also to their clients and the public as a whole, for whose benefit the market is supposed to exist. In the U. S. A., with this aim in view, the Securities Exchange Act of 1934 has provided rules to regulate 37 relationships between buyers, sellers, short-sellers, lenders, their brokers and the Stock Exchange and the stock clearing corporation.

35. The rules and practices on the exchanges should be published for the guidance of their members as well as the public. This requisite is particularly important, if contracts between members and their clients are subjected to the rules and practices of the exchange. The exchange should set standard practices in the market and should maintain a high standard of commercial honour, principles and integrity among its members. By rules, the public should have access to the management of the exchange to seek remedy against the wrongs done by its members. Under such circumstances, the exchange should settle disputes between members and their clients, if the former's contracts with the latter are subjected to the rules and practices of the exchange. Besides, rules and practices should be calculated to regulate the volume of speculation with a view to serving only the needs of liquidity and price continuity.

36. The management should be firm and should put down all sorts of manipulations by members, or by others through them. The normal course of supply and demand should not be interfered with, in the sectional interest of traders, whether 'Bulls' or 'Bears.' But the management ought to intervene when extraordinary circumstances, such as a 'corner' or unjust 'bear-raid,' threaten equity in dealings. Besides, culprits should be adequately punished and discipline should be maintained. The executive head of the exchange should not himself be a professional trader in the market, so that he may be in a position of wantage for administering the rules scrupulously and firmly.

37. There is a great responsibility attaching to the membership constituting the exchange, seeing that almost all the capital of the

public companies is traded on the stock market, and in addition a large volume of bank credit is used in speculative dealings. Moreover, members apart from trading on their own account, are also advisers and broking agents of the public. The public is generally guided by the brokers' advice, given orally or through periodic circulars. Therefore, the regulation of the volume of speculation, however strict the rules may be, depends much on the co-operation, moral standards, integrity and experience of the brokers. The rules regarding membership are therefore most important and those must be strictly enforced.

38. For discharging such heavy responsibilities, the membership must be limited to men of high financial standing, and experience in the profession. A period of apprenticeship and training may be enjoined as a necessary qualification to membership. Any mode of selection for membership may be adopted—and methods vary in the various countries; but what is wanted is that the training, experience, moral standards and financial status must be adequate to cope with the heavy responsibilities of membership. Broking and dealing activities must be regulated, whether by separation as in the U. K., or by detailed restrictions as in the U. S. A.

39. Above all, members' relationship to customers should be defined and enforced by the exchange. Credit facilities to members, and by members to clients, must be strictly regulated with a view to preventing over-trading. A schedule of minimum brokerage should be fixed and enforced. Settlement of contracts must be supervised by the exchange. Settlement by compounding with other members, through private compromise in the event of difficulties, should be forbidden at all costs. Failures, misconduct and undesirable activities by members should be widely published for the knowledge of the public. Daily reports of the volume of transaction should be insisted on from members. Auditing and periodical examination of members' books must be undertaken by the Exchange authorities, so that fraudulent transactions may be prevented. The financial stability of members to fulfil their contracts should be maintained, and this may be done by the principle of *solidarite* as in France, or by a guarantee fund as in Holland and Japan or by a strict auditing system as in the U. K. and U. S. A.

40. The value of the stock market as an agency for correct evaluation of securities and discounting of uncertain future trends of business depends largely on the prompt supply to the public of accurate data regarding securities and the condition of their issues, especially companies. Therefore, there should be an efficient information service for the use of the buyers and sellers as well as of the public. Not only should price quotations be published daily but all relevant facts regarding securities also should be periodically published. The withholding of relevant information regarding the state of companies has in the past enabled some persons in collusion with some members of the exchanges to make selfish use of inside information. Therefore, provision must be made for the prompt publication of all information regarding companies whose scrips are traded on the stock exchange, so that facts regarding the condition of the company, its dividend, etc., may be common knowledge of the public and not be used anti-socially by a selfish few.

CHAPTER VI.

THE INDIAN SECURITY MARKET AS IT IS.

How far does the actual condition of the Indian security market fit in with the picture drawn in the previous chapter? There has been for some time a growing complaint that stock exchanges have not been working satisfactorily. Not only the financial journals, but also several bankers and prominent businessmen have expressed grave concern regarding the working of the Indian stock market. The charges are chiefly in regard to the evaluation function and equity in dealings. We have therefore to look into this matter in some detail.

Wild Fluctuations in Stock Prices.

2. The principal charge is that owing to excessive speculation, wide and wild fluctuations in stock prices have taken place frequently, with the result that price continuity of securities has not been maintained, and that they have not been evaluated at their true investment worth. Any deep delving into figures is not necessary for testing the truth of this. A glance at charts given in Chapter VII will show that violent fluctuations have taken place in prices of stocks, whether singly or in groups. The case of the Indian Iron and Steel Company shares is perhaps the most glaring. Twice in the last ten years that security shot up to unwarranted heights, and then slumped with equal rapidity. The results of such violent fluctuation were much more than the crises and failures which came into public view. That price fluctuations have been much more violent in India than in other countries in recent years is also clear from chart A.

Who is to Blame?

3. The reality of such fluctuations and the mischief they do are not doubted. The question is, who is to blame? The stock exchange authorities generally disclaim responsibility for the violent price fluctuations. Such has been the attitude of exchange authorities in other countries too. When, after the violent stock market crash of 1929, the President of the New York Stock Exchange was asked what was the reason for the wild rise of stock prices before 1929, he replied: "Ask the 123,000,000 people of the United States." The implication of course was that the public had gone crazy and had worked up prices. But the lie direct was soon given when it was shown with facts and figures that only a small proportion of the population had been engaged in speculation, and that most of the speculation had been initiated and whipped up by the members of the New York Stock Exchange themselves.

4. The authorities of Indian stock exchanges are not so unwary. They know too well that only an infinitesimal portion of the Indian population has any part in stock market speculation. But they put the blame on outside brokers and speculators who deceive the gullible public by their manipulatory tactics. There is no doubt that outside operators, whether free-lance brokers and speculators, and influential syndicates of them, have also been instrumental in carrying out the manipulations which led to violent fluctuations in stock prices, but it is by using the exchanges that they carry out their nefarious operations and as it is well-known that nearly all our stock exchange transactions

are initiated and whipped by the members themselves, manipulations cannot have been possible without the co-operation of the stock exchange members. And it is a well-known fact that many members of our leading stock exchanges participate in the operations of the neighbouring curb markets, which have greatly helped in pushing on manipulations.

5. We will now see what the trouble is in the Indian security market. We will first take up the stock exchanges, next the curb markets and independent firms and finally some of the other agencies connected with the issue of securities or otherwise linked up with the security market.

(a) STOCK EXCHANGES.

Defects in the System of Settlement in Force.

6. As has been made clear in Chapter IV, the principal defect of the Indian exchanges is in the system of settlement. Legally each contract is to be fulfilled by delivery of scrips and payment of price. If this is enforced and settlement of bargains is made within the time limit fixed, an orderly market will be maintained and speculation will serve a useful purpose. But it is easier to make a settlement of contracts by payment of differences in price, and this is what too frequently happens even on well-organised stock exchanges. It is this that serves as the main facility for over-speculation. As no delivery or payment is needed, people can speculate to any extent without having the means. In this way, excessive speculation and over-trading are brought about, crises arise in the stock market and even the credit structure of the country is endangered.

7. The main defect of the settlement in force is the facility for postponement of contract, by *budla*. The operation of *budla* has been explained in Chapter IV. It is in fact the worst form of credit facility that can be given to a speculator. The real defect of *budla* consists in the advance of credit without any adequate pledge or security. Thus *budla* transactions not only add to the volume of speculation; they also encourage speculators to over-trade, and thus endanger the entire credit structure.

Easy Credit Facilities.

8. Besides *budla*, there are other credit facilities available to speculators. Those are: (i) accommodation for margin trading extended by brokers as well as by many banks; (ii) advances by money-lenders and certain banks on low margin and sometimes without any margin (as in *budla*); (iii) facilities for short-selling; and (iv) the use of blank transfer. All these directly or indirectly lead to excessive speculation.

9. How margin trading leads to over-speculation has been explained in Chapter IV. The practice of blank transfer gives undue facilities for speculation. Blank transfer enables easy credit to be raised from banks and thus much money is made available to speculators. But the credit thus advanced is often without adequate margin, and the banks and *budliwalis* who thus advance credit are therefore exposed to serious risks. If the market in the meantime moves down, heavy capital depreciation will result and all except the short-sellers will stand to lose. This is what happened at Calcutta where many non-scheduled banks had been making advances on scanty margin for

share transactions. As will be shown elsewhere, blank transfer is also causing enormous tax-evasion under transfer stamps and income-tax.

10. It is the easy availability of credit facilities that make the Indian stock market fall a ready prey to over-trading. The well-established banks are always cautious, and so also the larger broking firms. But there are private lenders and even banks to back up speculators engaged in risky business and brokers can also be found to accept their orders. In other countries, such undue facilities have been controlled by compulsory margins being fixed. If this has not radically cured the evils, it has at least reduced the risks greatly.

Private Compromise.

11. A principle which has to be strictly stuck to for orderly trade on a stock exchange is that a bargain once entered into in the market shall be implemented regardless of consequences. This may mean great inconvenience and hardship to individuals, but common good must take precedence. This is the principle relentlessly enforced in London and other markets. But in India, private compromise is very common, and in spite of rules to the contrary, it is going on even on the recognised stock exchanges, and it is learnt that even the exchange authorities use pressure on unwilling creditors to compromise with their debtors. The Morison Committee found that private compromise was one of the chief causes for unhealthy speculation and over-trading in Bombay, and strongly condemned it. There is no evidence that any noticeable improvement has taken place since, even on the Bombay Stock Exchange.

Put-through Business.

12. The practice of 'put-through' business, prevalent among members of Indian stock exchanges, is found to foster inordinate speculation, often resulting in defaults and failures, and even crises some time. The ostensible object of this practice is this. A member who may have received a substantial order from a client who purchases or sells securities is deterred from executing such order in the name of his own firm by reason of his belief that the market will be put up or down against him and that his client will consequently be a loser. To obviate this difficulty, different members are employed to execute the business in the trading ring. It is the presence of Taravanivalas in Bombay and Shunters in Calcutta that makes such a practice perhaps necessary.

13. As the Morison Committee points out, such practice is legitimate when inspired by an honest desire to serve the best interests of the non-member, but it has led to serious abuse in more than one way. It is through put-through business that cornering is successfully effected in any stock market. When purchases are made through so many different brokers, the development of a corner may not be noticed by exchange authorities and the technical position of the market may not be visible to them before the clearance day. Further, when an influential broker resorts to put-through business for executing large orders, through many brokers, often the same parties, usually the smaller brokers, may purchase or sell, leading them into a technically difficult position, wherein they are not able to liquidate their commitments. Often this has been found to be the reason for the failure of many ~~small~~ brokers, leading the market to crisis involving large amounts of credit.

14. Although put-through business is resorted to ostensibly in the best interests of the client, it often causes loss for him by being charged double brokerage, often without his knowing it. The principal broker thus gets a payment, although doing hardly anything for the client.

15. Another serious evil of the system is that it gives opportunities for authorized clerks to trade on their own account with the help of other firms, without involving their own principals. This also is bound to lead to commitments by people with inadequate resources to answer their liabilities in the event of transactions ending in loss. In the course of this enquiry several instances of authorized clerks trading on their own account have been noticed, nearly on every exchange. Although every exchange prohibits such trading, no exchange is found to enforce it rigorously, and in the result put-through business has brought about many evils.

Speculation in Cash and Forward Markets.

16. Having considered how certain facilities available to stock market operators are being utilised for excessive speculation, it may now be asked in which of the two systems—cash market or forward market—speculation is more liable to exceed its limits.

From the descriptive accounts of the market given in chapter IV, it must be clear that speculation can be done more easily in the forward market: it is in that market that speculation is more liable to get out of control. It is the long settlement period and the temptation for speculation on time bargains in the meantime that cause the trouble. Each contract should end on the day fixed, by delivery and payment, but in practice this seldom happens, because it is for making profit out of time bargains by successive purchases and sales crossing each other during the interval between two successive settlements that speculators carry on forward dealings. Therefore, in effect, most transactions are only settled by payment of differences in prices. Moreover, many contracts are also closed for the current settlement by the process of budlying. This is specially the case in the forward markets of Bombay and Ahmedabad.

17. The result has been excessive speculation in those markets. In 1937, the Morison Committee stated:

"Of the total business transacted on the Bombay Share Bazaar (i.e. Bombay Stock Exchange), too high, indeed much too high, a proportion is of a speculative nature—several witnesses estimated such business at anything between 80% and 90%—and of the speculative business a very high proportion has degenerated into a mere gamble in differences, thus constituting an ever-present threat to the continued existence of the bazaar as a serious place of business, capable of discharging with efficiency its proper functions as an important and essential part of the economic machinery of the Presidency and of the country."

Stock exchange transactions it is true, need not be injurious merely because 80% or 90% of them are speculative in character: for this may be true of the best-conducted stock exchange of the world. But, the Committee went further and claimed that a high proportion of this speculative business had "degenerated into a mere gamble in differences". It is true that the Committee has not adduced adequate proof for this conclusion, but they clearly state that they were "satisfied from the evidence placed before them." It is difficult to

believe that "a clamorous and redundant minority" forced their views on such a competent Committee.

18. It must be due to the connection between forward dealings and excessive speculation that the Bombay Government has taken measures to keep operations in the forward market under State regulation from as early as 1925, while leaving the cash market free. But, these measures have not succeeded to any appreciable extent. In 1937, therefore, some persons held the opinion that forward dealings should be stopped altogether, and this was one of the chief questions placed before the Morison Committee by Government. The first item in their questionnaire was: "Should forward trading be stopped completely or should it be allowed with restrictions, and if so, what restrictions"? But the Committee, it must be said, did not face this issue squarely. Not only did they not recommend the abolition of forward trading, but suggested steps for widening its sphere, although this was done on the assumption that it would reduce the wild price fluctuations in the market. Nevertheless, it was up to them to state the reason why the first alternative placed before them was not seriously considered. Perhaps the Chairman of the Committee, who was long connected with the London Stock Exchange was (like many others) unable to differentiate speculation from forward dealings, and therefore, did not consider any answer for this necessary. But Bombay is not London. The authorities of the London Stock Exchange have enforced their rules relentlessly, but all people are not as severely disciplined as the British. Each country must adopt systems suited to its genius and environment. In a country where a powerful inclination to gamble is prevalent, the forward market can do much harm, and this has been recognised by many practical nations like the Dutch and the Americans.

19. It is of course in times of crisis that the forward market causes the worst evils. The need for suspending it in times of war has been recognised; but it can be equally injurious in times of political uncertainty and national panic like those we have lately passed through. Especially in May, 1947, the prices of scrips in the forward list of the Bombay Stock Exchange went down continuously under pressure of persistent bear raids. The bears were thus allowed to rob the investing public mercilessly and a serious financial crisis was threatened. The crisis has passed for the time being by the improvement in the political situation, but such situations have recurred and may recur, and the wicked bear raids should not be allowed to go on against the interests of the investing public.

Equity in Dealings.

20. An important function of the stock market is to provide equity in and safety for dealings. As stock exchanges in India are only organised for the benefit of their members, no adequate protection is provided to the public (i.e., clients dealing with members), whether in the constitution or in the rules relating to the conduct of the trade. It is true that in the case of two recognised stock exchanges, the bye-laws in the constitution and certain rules and bye-laws make some provision for some kind of protection to the public. But it is doubtful whether in practice these objectives have been properly carried out to any appreciable extent. In regard to the other exchanges, mostly joint stock companies, protection to the public has not even been mentioned among the objects of the exchange. Members of exchange are expected to do brokerage work for the public; but in practice

no exchange in India has been found to insist on their members executing agency contracts with clients. In fact, every contract with a client is only a dealer's contract and the client has no means of knowing what price his broker has obtained for his sales or paid for his purchases. Similarly, no brokerage is separately mentioned in any contract. Thus a client, be he investor or speculator, is denied the opportunity to know the real price at which his purchases or sales were made. Except in the case of a few reputed firms, this privilege of members has been found to be abused and this has caused serious annoyance to the public. Numerous cases of sharp practices by members have come to my notice in the course of the enquiry.

21. In regard to the delivery of scrips, although every exchange has got rules and bye-laws governing the conduct of trade between members, no exchange has any strict rules to regulate the relations between members and their clients. In the result, in a rising market delivery to clients is often found postponed and in an unfavourable market the members are found to insist on the acceptance of delivery by clients. Many cases of brokers defaulting to pay to clients the prices of shares sold, even running away with the clients' money, and also instances of clients' securities being pawned by the brokers have been brought to light in the course of this enquiry. Especially mofussil clients have incurred much loss this way, and this has brought stock exchanges into evil repute.

22. Sharp practices are prevented on the London Stock Exchange by the strict division of the members into brokers and jobbers. But as the functions of broking and jobbing are combined in Indian exchanges, a clash of interests between the two parties is bound to happen when clients' orders are executed by members. This has been the principal complaint of many members of the public, whether investors or speculators. In fact, it is believed by many influential persons that a separation of the two functions will rectify all the evils in the Indian stock market.

23. In the U. S. A., where such distinction between broking and jobbing is not strictly enforced, evils similar to those in India prevailed formerly, and consequently the Securities Exchange Act of 1934 has made provision for stamping out such shady practices. Although on the American exchanges there is no clear-cut division of functions between broking and jobbing as in London, provision for equity to the public has been made by members being strictly prohibited from entering into dealers' contracts with their clients. Thus in the practice of the New York Stock Exchange, contracts are strictly divided into agency contracts and dealers' contracts. If any broker wants to trade with his clients he is to take a written agreement from the client permitting him to do so and this has to be submitted to the exchange authorities for their timely information. Besides, by the provision for strict periodical auditing and examination of members' books both by the exchange authorities and by the officers of the Securities and Exchange Commission, such abuse of the privileges of a member against the clients' interests is prevented.

24. While a two-fold protection is thus provided to the public in the U. S. A., firstly, by the supervision of the S.E.C. and secondly, by the exchange authorities themselves, hardly any protection is provided in India from any source, and hence the gross inequities mentioned authorities of the exchange for the legitimate redress of grievances at Calcutta), the aggrieved parties have been denied access to the authorities of the exchange for the legitimate redress of grievances against members. In other countries, rules of the stock exchanges make

provision for the arbitration of disputes between members and their clients. In India, with the exception of the two recognised exchanges, this legitimate remedy against stock exchange members is denied to the public.

The net result of all the above is that equity is often denied to the public, whose benefit ultimately is the sole justification for the existence of the stock market.

Lack of Rules and Laxity in Enforcement.

25. In the case of some stock exchanges, short-comings in the conduct of business may be due largely to defects in the rules and regulations of the exchange. In the case of well-established stock exchanges, however, there are elaborate rules drawn up, but they are often not enforced or their violation is connived at. All long-established exchanges have rules prohibiting private compromise, but as shown above, this is honoured more in the breach than in the observance. In respect of many rules, enforcement on the Calcutta Stock Exchange is found to be very lax. To take up one instance: the rules of that exchange insist on members not pursuing other professions. Yet it has been found that in practice several members freely engage in other occupations also, thus making them liable to serious risks. Rules also prohibit members from trading on other exchanges, and these have also been frequently and glaringly violated. Even more serious is the non-enforcement of the rules regarding delivery. The Calcutta Stock Exchange permits only cash dealings and deliveries are supposed to take place on the third day of the transaction, but actually deliveries have been unduly delayed, taking umbrage under the vague wording of the rule "on or after the second day from the date of the contract." As has been shown in Chapter IV, deliveries have been in actual practice delayed, not for weeks but even for months, and especially after the clearing work by the Allahabad Bank ceased, the position has become much worse. Facilities for excessive speculation are thus provided and members are also enabled to profiteer at the cost of their clients in several ways, thus violating the equity between the members and the public.

Weakness of the Managing Boards.

26. Such laxity in the enforcement of rules is generally due to the weakness of the exchange authorities. The managing boards of even the leading exchanges are weak and in some cases unwieldy, and are constitutionally averse from enforcing rules when it proves inconvenient to them as members. There are few members on the board who could take an independent line and are able to pull up the board when a wrong decision is taken, and the chairman himself, being drawn from among the members in most cases and depending upon periodical election by his fellow-members, is often unable to perform his duties with a firm hand. It is no wonder that even in the case of the Bombay Stock Exchange several responsible members according to very reliable authority refrain from seeking election to the governing board. If this is true of the Bombay Stock Exchange, which has been working under rules recognised by a Government, what must be the position of the many inadequately organised exchanges that have lately sprung up?

27. In spite of all these defects of the organised stock market, it must be said that it has helped in maintaining continuous marketability although to a small number of securities, and if this has been often at the expense of price continuity and if correct evaluation of securities has not often been made, the blame for this cannot be laid entirely at the door of the stock exchanges. In many ways, this has to be answered by other sections of the stock market, as will be shown presently.

It is also fair to recognise that owing to lack of investment banks and underwriting houses in this country, it became necessary for the members of the stock exchanges to take up such functions also. Company flotations and the primary sale of securities would have been greatly handicapped, had it not been for the active co-operation given by the stock exchange members in this matter, although this work has not been done by them as members of stock exchanges. Thus the stock exchanges, in spite of their defects, have proved beneficial in harnessing capital for productive purposes, and for imparting liquidity to a part of it (listed stock) and if more has not been done, part of the blame must be borne by Government which has so far done very little to guard the investment market from nefarious influences, some of which will be detailed in the rest of the chapter.

(b) STREET MARKETS AND SHARE BAZAARS.

28. As mentioned in Chapter I, the curb markets in India still work in streets, with no legal entity nor any proper constitution. They also trade in the same securities as the stock exchanges, rather in the more active counters among them. In these street markets, hundreds of brokers and dealers participate in speculative group bidding according to some common practice. Their contracts are settled by payments of differences at closing; delivery of scrips is neither given nor taken. In other words, their business is gambling pure and simple.

29. Such being the nature of the street markets, it is no wonder that their turn-over of business became large, especially in war-time when inflation ran wild and much black market money was floating about. Thus hundreds of speculators have come to congregate in these dens, lured by the urge to make quick profits. At the Katni market of Calcutta, it is believed that more business is carried on than on any stock exchange in India. It works from morning till late in the evening, while the stock exchange works only for two hours, from 12 noon to 2 p.m. A vast concourse of people meets there and carries on business in great excitement, using quaint symbols with the help of fingers.

30. These street markets have hardly any legal status. They have no deed of association to bind them for maintaining the common practice whether for their own good or for the safety of the people who deal through them. It is true that most of them have their own private committees for the management of the affairs and settlement of disputes. Nevertheless they are neither legally authorised nor competent to exercise any discipline nor to maintain an equitable practice in the market.

31. None of the recognised qualifications for the membership of a stock exchange are required for being a member of share bazaars. Any one can enter as a broker cum dealer in the street market if a

few others are willing to trade with him. Then he becomes a recognised broker *cum* dealer and is able to obtain credit facilities from *badlivalas* and even from members of stock exchange, as the latter too do business through such people. It is learnt that smaller banks too often give credit facilities to these curb dealers. In this way, street markets and share bazaars have given rise to a large number of irresponsible professional speculators, with no rules to bind them and with no authority to curb them.

32. Serious results have come out of such developments. These street markets have proved most injurious to the public and to the more honest among the brokers themselves, and they have become a menace to the organised security market and to the credit structure as a whole.

33. Firstly, these street markets have been instrumental in lowering the commercial morality in the stock broking trade by conniving at, if not abetting, many fraudulent practices which unscrupulous dealers have been resorting to in their scramble for profits. It is the lack of definite rules and practices that enables brokers to deal with clients as it suits them. Many instances have been noted, of brokers opting out of contracts, not fulfilling stipulated engagements with clients at the appropriate time, but all the same, insisting on fulfilment by clients in times unfavourable to the latter. In such cases the position of the broker is protected in every way against legal remedy because of the vague generalized condition, that the contract is "subject to the practice and usage in the market." Further, according to usage, contracts to clients are entered into by brokers, only as dealers (not as agents), and that too without time limit for the performance of making or taking delivery. But in the event of a client's non-fulfilment or default, the broker is not only enabled to enforce the contract through the law courts, but has also alternatively a quick remedy to make good his loss by appropriating the margin or the advance of the client. Thus in this vicious system, the broker gets ample chances to defraud his client at every turn in the course of an operation, taking umbrage under the Contract Law, while the safety for and equity in dealings to the client is entirely left to the good sense of the broker. Many defaulting brokers thus escape without surrendering their assets to answer their liabilities, as remedy cannot be effectively sought in a court of law. Several instances of such fraudulent practices were noticed in the course of the enquiry, for instance, in the dealings of the shares of the Indian Aluminium Company.

34. Many innocent people have thus been lured into the meshes of these brokers through their enticing advertisements, circulars, market reports, touting and seemingly generous provision of facilities for credit and margin trading. In addition, large-scale group bidding has also been going on in these street markets without proper contracts between dealers and these have been found to cause (in addition to colossal loss of revenue to the Government, of which see later) frequent defaults and failures in the market with serious repercussions on the economy as a whole.

35. Secondly, the curb markets have contributed to rapid fluctuations in share prices leading to serious crises in the security market as a whole. This may be seen from what lately (since September, 1946) happened in respect of active counters like Indian Irons, to the violent fluctuations of which recently, reference has been made. (It must be noted that the Katni has for long concentrated on one or two shares like Indian Irons).

36. Thirdly, the operation of these street markets has greatly affected the organised security market in the country. This is inevitable, because these street markets deal mostly in securities listed on the stock exchanges and actively traded in them. Further, many of the broker-members of the stock exchanges operate also in the street markets, especially as the street markets work in the close vicinity of the stock exchanges, and work from morning till late in the evening. In this way the two markets get intermeshed and the erratic price movements on these create disturbing repercussions on the organised stock market also. The low brokerage on the curb has also seriously affected the business of the organised market. Thus, these street markets have become a serious obstacle to the safe working of stock exchanges, and no reform of the latter will be effective unless the former are closed down or thoroughly reorganised as to be complementary to the latter.

37. Fourthly, the jumbling of irresponsible professional speculators and stock exchange members in the integration of the curb markets has been found detrimental to safety of the credit structure as a whole, and this can be seen from what happened in Calcutta quite recently in regard to the numerous banks which had advanced liberal credits for share dealings in and outside the organised market.

(c) INDEPENDENT FIRMS & OUTSIDE BROKERS.

38. Although the turn-over of business of independent firms and outside brokers (who form the 'over-the-counter market') may be less than that of the street markets and share bazaars, the activities of the former are found to be much more injurious to the orderly functioning of organised stock exchanges and are greatly more responsible for swindles in the share trade. In many cases, the manipulations on the organised exchanges are engineered by private dealers.

39. Although dealing in stock is a highly responsible occupation, there is nothing to prevent any one in India, whatever be his financial stability or integrity, from engaging in such dealings, and therefore numerous private share dealers have sprung up all over the country, especially during World War II. Some are private proprietary concerns or partnerships; but latterly the tendency has been to organise limited liability companies, whether private or public. It may be seen from what follows that this preference to corporate form is due to the facilities provided by it for raising funds with the greatest ease.

40. The business of the independent firm is generally of a comprehensive character. They do not confine themselves to stock dealings; many of them also carry on speculation in bullion and commodities and some do even banking and managing agency work. They can act as broker or agent, or as dealer or as underwriter or issue house, and do all such functions simultaneously. Nor is there anything to prevent such combination of functions in this country, however strict the provisions against it may be in other countries.

41. Taking only the business of stock dealings, the firm is entitled to trade in any security listed on any stock exchange in the country. It can also trade in securities not listed on any exchange. Thus the field of activities of these firms is almost unlimited compared to that of the stock exchanges, whose scope of business is severely limited by rules. The result of such unrestricted freedom is appalling. There are today private dealers and firms not only in large cities but even in the smaller towns. In the larger cities they function side by

side with stock exchanges and street markets, and are a serious hindrance to the orderly working of the organised security market.

42. These independent firms, especially joint stock companies which have taken up this work, have gathered large funds for effectively pushing on their share speculation. They collect funds in several ways, chiefly by issue of shares. They often issue different kinds of shares having varying rights to profit. The ordinary shares, fully or largely paid-up, are unloaded on the unwary public, but along with this are also issued deferred shares which, while having only a small paid-up capital, are entitled to full dividends, and of course these shares are retained by the management and their friends. These companies raise funds from the public in other ways also, e.g., by offering high rates of interest for deposits, or even receiving deposits on a profit-division basis. In this latter case, the margin of profit offered is higher than the interest allowed by banks or even the investment yield from securities. Sometimes they combine fixed interest with a share in profit. They attract such deposit by alluring advertisements by which they make the public believe that high profits will come from the capital appreciation resulting from intelligent speculation. By offering such baits to the unwary but gullible public, they raise funds for their speculative ventures. It has been found that not only limited liability companies but also partnerships and proprietary firms are collecting deposits in this way by drawing into speculation a great deal of capital which ought to go into productive activity. They are evidently doing the greatest injury to the national economy. But such anti-social activities are not the concern of any public authority in the country.

43. Unlike the members of stock exchanges, these outside dealers are not precluded from sending out open circulars and they make full use of this freedom. They advertise widely in newspapers and issue their own financial bulletins, etc. In this way, they collect orders for speculative share purchases. By offering credit facilities on attractive terms to those who speculate through them, and even by accommodating their clients by taking their orders on account, they have drawn into the vortex of stock market speculation large number of persons of small means and some of these have already burnt their fingers.

Connection with Stock Exchanges.

44. We have seen that these private firms are absolutely independent of the stock exchanges, but it does not follow that their operations are unconnected with the work of the organised stock market, directly or indirectly. But the connection between the two is subtle. Several of these private dealers are found to work as agents of stock exchange members. This is done extensively in upcountry places, but this also goes on even in cities where there are exchanges. Legally this action can be construed as mere clientship; but in reality it is a partnership in the brokerage business. The private dealer is often found doing the work of the tout, canvassing business for the members of the stock exchange on a half-commission or half-brokerage basis. The business thus brought is mostly of a speculative character. It is such dealers that rope in unwary persons of the middle class—teachers, lawyers, clerks, and others of small means into the speculative business. They are attracted by the lure of vast profits but in most cases the result is the loss of their life's earnings.

45. But the connection of the private dealers with stock exchanges is much more than mere agency. In fact, they constitute a different

division of the market trading in the same securities. They too are found to concentrate on active counters on the organised exchanges. This not only adds to the volume of speculation in the same counters; it also nullifies to a large extent the disciplinary effect of whatever collective regulations obtain on the exchanges.

Manipulations.

46. These outside brokers are often also manipulators in the stock market. They are found frequently to create disturbances in the stock market by interference with supply and demand to suit their own ends. Corners of the exchanges are often created by them. They have certain special facilities for such manipulations. Firstly, they have large resources raised by several methods as shown above. Secondly, like investment trusts they can hypothecate the securities in their hands for raising further credit and use it again for more purchases. Thirdly, as independent firms, they can work up cornering by means of put-through business without the knowledge of others. Neither the members nor the management of the exchange will know that the same party is purchasing from the market. But if members of the exchange individually or as a group attempt a corner secretly, this is likely to leak out. Further, the exchange authorities will have some warning of this from the clearing house where there is one and therefore they can take timely action to prevent a crisis. But independent firms or dealers can work up a corner without the management of the exchange coming to know of it, although the operation is done through its members. Remedial action therefore is not possible in time and consequently attempts at cornering by private dealers can throw the entire organised market out of gear. It is even possible for them in such situations to insist on fulfilment of contracts and thus extort much money from members and speculators and even investors. Sometimes such activities may produce even a crisis in the market and thus jeopardize the solvency of the members. When members fail, investors will also suffer losses. Only one party remains unhurt—the private dealer—and he can extort money from his clients at every stage.

47. Even during their normal operations, these firms create wide fluctuations in stock prices. By suddenly putting thousands of scrips on the market or withdrawing large quantities from it, the dealer is able to rig up or bring down prices as it suits him, and with such operations at convenient levels through put-through action, they can extricate themselves from the current they create, but can draw others into it. In this way they have been repeatedly mulcting innocent people of their hard-earned money, and this has caused serious embarrassment to institutions like insurance companies, trusts, banks, benevolent societies, etc.

Their Bear and Bull Tactics.

48. We have seen that these firms carry on a multiple trading—stock, bullion, commodities, banking, etc. Such interlocking of stock dealings with commodity speculation has been upsetting the orderly functioning of the security market in many ways. When speculation is found more profitable in any other line, such as, bullion or cotton or jute or oil-seeds, by a rise in their prices, they suddenly liquidate their holdings in stock to take advantage of the upward trend in other markets. This sudden over-supply of scrips causes a precipitous fall

in prices in the stock market. Even in the falling market thus created by themselves, they are often found to take advantage of bear-selling, thus making the fall in price all the steeper. Such action generally creates panic among the real investors and they too rush into the market to liquidate their investments. Naturally this results in a loss to the genuine investor. Moreover, credit institutions like banks and insurance companies who often want to convert their short-term investments into cash in order to answer the demand from their depositors or creditors, often suffer heavy capital depreciation, on such occasions.

49. On the other hand, when there is a rise in stock prices, private dealers put on the reverse gear; they liquidate their holdings in bullion and commodities and rush into the stock market, this time as bulls. Here again, they try to corner and rig up the market with a view to profit by price fluctuations. Watching the upward trend of stock prices, speculative investors too are attracted. Even genuine investors also may be tempted to buying stock in such circumstances. After having the markets rigged up to unwarranted heights, they suddenly release the corner. Thus at every turn they are found to upset the orderly functioning of the market and at every such fluctuation they, being experts, loot the real investors, credit institutions and speculators of lesser experience.

50. Even if these manipulators fail in their nefarious activities, the actual loss will not be on them. It has already been mentioned that the bulk of the capital they use for their speculation is obtained from the public, by the issue of shares, by accepting deposits and raising credits from the banks. If the manipulators lose in the transactions, the loss is transferred on the public, but if they gain a large portion of the profit is invariably appropriated by the management. Thus in either case, the public is defrauded.

Arbitraging.

51. These independent firms also carry on arbitraging between markets. They skilfully watch the trends of prices in different markets and benefit by them. In towns where stock exchanges and curbs exist side by side they directly participate in the business on the street markets and indirectly do business on the exchanges through members on half-commission basis. It is these unregulated facilities coupled with the lack of rules to maintain a minimum schedule of brokerage and to enforce delivery and payment on the street markets and over-the-counter markets, which breed so much of undesirable arbitraging between the organised and unorganised market. Often such unregulated arbitraging is found to give rise to a train of malpractices in the security market. Usually it nullifies to a large extent the effect of collective regulations on the stock exchange. The practice of such unhealthy arbitraging is found to influence the price movements to the detriment of honest investors and credit institutions. Often the members of the public are also led into the vicious circle of such unhealthy speculation.

52. Not satisfied with their copious gains from stock market manipulations, these private firms and dealers have also operated in the field of company promotion and share pushing, and they have had some part in the staggering operations that have been going on in many Indian cities since 1942. In complicity with certain managing agencies and stock exchange members they have been playing a part, not only to rig up the price of the new issues of shady ventures, but also to get such issues listed on stock exchanges.

(d) MANIPULATIONS BY OUTSIDE OPERATORS INCLUDING COMPANY PROMOTERS AND DIRECTORS.

What is Manipulation ?

53. [By manipulation is meant "a planned effort by an individual or group of individuals to make the market price of a security behave in some manner in which it would not behave if left to adjust itself to uncontrolled or uninspired supply and demand." The object of manipulation is usually to force the price of a security upward so that holders of large blocks of shares may be enabled to dispose of their holdings advantageously to themselves. Manipulations may also be organised by forcing the market price down, either as a part of the campaign on the short side of the market or to facilitate covering of small commitments already outstanding. Thus manipulation deliberately interferes with the free play of supply and demand.] Generally groups of individuals or corporations, combine temporarily into a pool for carrying out manipulations. Options are widely used by these pools. Such manipulations had been very common in the United States in the nineteen twenties and early thirties. Manipulations have been employed very widely in connection with company financing as also the secondary distribution of stocks. Some of the American manipulations,—the Radio Pool (1929), Fox Theatres Pool (1928-29), etc.—have become notorious. Manipulations in America are generally carried out on the floor of the exchanges, but some were operated outside the exchanges. Many of the operators were not members of the stock exchanges but they were able to use the machinery of the exchanges.

Manipulations in India.

54. In India also manipulations have been a common feature for many years. They are worked up mostly by members of exchanges, and sometimes by outsiders. Syndicates are often formed for this purpose. In India too the operators have been working on the gullibility of the public by using various tactics for creating artificial market activity—such as 'wash sales' and 'matched orders' intended for creating a false or misleading appearance of market activity. False rumours, collusions, fake transactions and the like have been employed, as also publicity through the press and through news bulletins, market reports, etc. Those who have followed the course of the Indian Irons racket in 1937 will realise what ingenuity could be employed in carrying out manipulation and for working on the gullibility of the public.

55. Manipulations have been worked up also by the directors and other officers of companies with the help of stock exchange members using inside information; they rig up or down the market in the shares of their own companies, and make large profits. This has been done chiefly at the first sale of securities; it takes place also in their subsequent sales.

Sharp Practices in Company Promotion

56. Although securities come into the organised stock market only after issue and first sale, these latter are also as much a part of the security market in the wider sense. Further, as shown above, owing to the absence of investment bankers and issuing houses, mem-

bers of stock exchanges perform some of those functions (although not by virtue of such membership). The issue and first sale of securities are therefore greatly intermeshed with the working of the organised stock market, and a great deal of manipulation has taken place in this field.

57. Sharp practices by promoters of companies and their friends at the stage of issuing and fresh sale of the companies' securities have become very common in India, especially during the last few years when large numbers of companies were floated for utilising the big war-time incomes reaped by some people. Although several of the companies were floated with highly inflated capital structures, a tremendous demand for shares arose among the credulous public, owing to the flush of idle money in their hands. An appetite for company shares was also whipped up by the glowing accounts appearing in prospectuses and in newspaper notices regarding the new issues. Thus before allotment even before issue, sometimes, shares came to be sold privately at a high premium. This gave an opportunity to company promoters to carry on "staggering" operations of the most objectionable kind and thus reap large profits. Subsequently, the facts came to be known and prices suddenly slumped, but before this, manipulators had sold away their holdings and the gullible public was left to 'hold the baby.'

58. The ingenious technique employed by these clever company promoters to hoodwink the public takes many forms, and considerable information about these has reached me. They show clearly that in this country there cannot be any safety to the investor, so long as such day-light burglary is allowed to go on. The poor man is sent to jail for committing a petty theft, but those who make millions by deliberately deceiving the public are seldom hauled up.

59. The predatory practices of these mischievous company promoters ought to have been nipped in the bud by a vigilant Government. Indeed there has been a Capital Issues control by the Central Government since 1943, but that control pursued the matter only till the consent for issue was given—and even that control has been concerned chiefly with the anti-inflationary motive and has not proved very effective in detecting the tricks used by many promoters for deceiving the public. In any case, what happened after the consent was no concern of any authority. No doubt certain returns have to be submitted periodically to the Registrar of Companies of the Provincial Governments, but this has been altogether ineffective in stamping out the sharp practices by which company operators have been deceiving their unwary fellowmen. In the result, the financial dealings of companies—so important from the point of view of industrial development—are almost as unregulated as the dealings in the shares, and it is futile to attempt such regulation by a haphazard system of capital issue control or by a half-hearted provision for an annual return to an over-worked Provincial Registrar who has neither the equipment nor the time for such difficult work.

Unequal Voting Rights.

60. Company promoters have also been employing various devices to keep voting power in their own hands. A device commonly used for this purpose is to issue "deferred," or "founders'" shares of small value with voting power equal to that of ordinary shares, thus vesting controlling power in a ring. In a certain application placed before the Controller of Capital Issues, Government of India, it was proposed

to allot to the managing directors 25,000 deferred shares of Rs. 100/- each, and as each as against 9,750 ordinary shares of Rs. 100/- each, this would give the managing directors a decisive majority in the company's Board. The justification given out for such grossly disproportionate rights is that this was meant to prevent men who worked hard in starting a concern from being ousted by outside financiers who buy up the shares. But the remedy is worse than the disease. Although the unfairness of this was patent, it was thought that the Government was not justified in using a war-time emergency measure like Capital Issue control for effecting drastic reform, whatever its desirability. However, some limit was indirectly placed on Directors' freedom in this matter, by laying down the rule that "issues shall not be allowed in which (disregarding debentures and cumulative preference shares, the holders of which have special voting rights) it is possible for parties who have subscribed less than 25% of the capital of an industrial concern (and 33.1/3% capital of other concerns) to have more than 50% of the votes." Government has objected in principle to issues including shares of a value of less than Rs. 5/- each.

61. Company promoters have also been trying by tortuous practices to undermine the power of the shareholders interlinking of companies and by various other methods. It will be necessary in this report to deal with all this, seeing that an amendment into the defects of the Company Law is under way in the Commerce Department.

62. It must be pointed out that the Government is not alone in this. The same is true of the other countries of the world.

62. It must be pointed out here that at least one stock exchange in India has, by insisting on strict listing requirements, discarded some of the practices mentioned above. The listing regulations of the Bombay Stock Exchange insist on voting rights being proportional to the amount of capital subscribed, and an offer to the public of at least 50% of the new issues and equitable terms of managing agency.

Unfair Use of Inside Information by Directors and other Officers of Companies.

63 Directors, agents, auditors and other officers of companies have been found to use 'inside' information for profitably in the securities of their own companies. This has been because, these persons obtain information before every change in the economic condition of companies, particularly, regarding the size of the dividends to be paid, the issue of bonus shares or the impending conclusion of a year. With such knowledge in their possession it became them to speculate profitably in the company's shares. In the U. S. A. effective provision has been made in the Securities Exchange Act of 1934, by the provision that directors and officers of companies and persons owning more than 10% of any registered issue of securities must file with the Securities Exchange Commission and the public statement of each such security, together with the changes that have occurred during each month. In this manner by such parties by whom securities are bought from them in Canada, the public disclosure of such transactions is made.

U. K. enquiries recently made by the Cohen Committee disclosed serious flaws in the company law in this respect and this Committee has strongly recommended that all such transactions by directors and other officers of companies must be disclosed promptly and an amendment of the company law in this regard is already before the Parliament.

65. In India, such special legislation has not been carried out and no provision exists in the present company law to bring to book directors and managing agents of companies who make such unfair use of inside information. Stock Exchanges could insist on listed companies giving publicity to material events like declaration of dividends, but their admonition often falls on deaf ears. The President of the Bombay Stock Exchange, in his speech on 14th June, 1947, gives glaring instances of leading companies neglecting to give prompt publicity to declaration of dividends and issue of bonus shares. In the case of the latter, the President states that "in each and every case where bonus or 'right' shares have been issued, information has leaked out well in advance of the official announcement." In the result the reaping of unjust profits by 'inspired' operators has been very common. It is a pity that this has not caused the public indignation that it deserves. This is largely due to the lack of understanding of the fact that the profits thus made by company directors and their friends are extracted from the pockets of the investing public. Such 'inspired' operators are no better than the common thief, and must be put down in the public interest. This may not be possible by merely amending the company law; incessant co-operation of stock exchanges is necessary for carrying this out, and such co-operation can only be effective if carried out under the auspices of some competent authority, as in the U. S. A., which has the personnel and the data necessary for scrutinizing the predatory activities of 'inspired' operators, from time to time. In spite of organised effects made in the U. S. A., mischievous action by company directors has not been altogether stopped in that country. How much more helpless will be the condition of the investing public in India if no such precautionary measures are taken?

CHAPTER VII.

THE ECONOMIC RESULTS OF THE INDIAN SECURITY MARKET.

Having dealt with the functioning of the security market, we may now enquire how far this market has succeeded in carrying out the objectives enunciated in Chapter V. For a full answer to this question, a thorough statistical study of the problem is essential; but statistics regarding stock market operations in India are meagre, as shown in Chapter III.

Correct Evaluation of Securities.

2. The first and foremost function which stock exchanges are expected to fulfil is the correct evaluation of securities. Even the most superficial study of stock market prices in India will show that price fluctuations have been a pronounced feature here. Without any change in dividends of companies or in their break-up value, or in interest rates, prices of stock have been violently fluctuating, largely by the manipulations of speculators.

Price Fluctuations in India and abroad.

3. This above can be demonstrated in various ways. At the outset we may compare stock prices in India with similar prices in other countries. In the following table are given index numbers of the market value of industrial shares in six prominent countries:— (See also Chart A facing page 86 showing price trends in the U. K., the U. S. A. and India, and Appendix A to this chapter giving monthly figures.)

4. It must be admitted that the period taken for the comparison in the above table is one of war in which many of those countries were exposed to serious external dangers. But it is significant to note that price fluctuations have been much more violent in India than in countries more exposed to danger—e.g., the U. K. and Australia. In July, 1946, the Indian Index stood at 400 as compared to 166 in the U.K. and U.S.A. India in this respect has behaved more like France than the more steady Anglo-Saxon countries. This may be due partly to national character, but the unsatisfactory functioning of the stock market had much to do with it.

Price Fluctuations in India.

5. We may now make a more detailed analysis of the prices of stock in India. For obvious reasons, we may exclude from our analysis the period when India was threatened by the Japanese invasion, because price fluctuations are inevitable in such periods of national danger (although in countries exposed to greater risks like the U. K. panic was kept under more severe control). Further, during the early years of war, stock prices were also influenced by inflation in general prices. Such influences became weaker after the end of 1944, when the risks of invasion subsided, and when the advance of inflation was kept under check. It may be even more fair to take the period after the end of hostilities. The one dominant feature of the whole of this period is the wild fluctuations in stock prices.

6. We will first take the prices of ten of the active counters in the Indian stock market. Chart B (facing page 88) shows the trends of the aggregate value of these ten securities (monthly plottings) and of their aggregate dividends. Contrast the frequent and wide fluctuations in Indian stock prices with the fairly even tenor of prices in the U. K. and U. S. A. Fluctuations from year to year can be studied in the following table. (See Appendix B to this chapter for detailed figures.)

TABLE 2.
Trends in share prices (10 securities) in certain months from
March, 1934 to December, 1946.
(In lakhs of Rs.)

| Year and Month. | Share price (aggregate of 10 securities). | Dividend. |
|-----------------|---|-----------|
| 1934 March | 11.42 | 52.3 |
| 1935 " | 15.56 | 37.0 |
| 1936 " | 12.12 | 40.0 |
| 1937 " | 33.84 | 94.7 |
| 1938 " | 20.08 | 162.2 |
| 1939 " | 21.07 | 117.9 |
| 1940 " | 28.29 | 157.6 |
| 1941 " | 28.27 | 190.9 |
| 1942 " | 23.95 | 199.8 |
| 1943 " | 32.51 | 175.8 |
| 1944 " | 36.47 | 171.9 |
| 1945 August | 36.69 | 168.4 |
| 1946 December | 62.58 | 156.2 |
| | 47.36 | |

7. The fluctuations brought out in the above table are often erratic and wild. Between 1934 and 1937, the aggregate value of the ten stocks actually trebled, although the dividends did not even double during the same period. During the next two years, aggregate values fell by more than a third, although dividends had been mounting up in the meantime. In war time, dividends continued to mount up, but stock prices lagged behind. On the other hand, in 1946, the prices of securities went up to high levels, although dividends remained stationary or falling. It is fully realised that dividends are not the only basis for the evaluation of stock, but it is bound to be the chief factor. The wild fluctuations in stock prices in India are due largely to mischief of speculators and syndicates of them operating in their self-interest.

8. The effect of such operations are seen best in the price fluctuations of individual scrips. The Indian Iron and Steel Company's ordinary shares rose from Rs. 6-6-0 per share in June, 1934 to Rs. 60 at the end of March, 1937 (more than nine times) and higher up to Rs. 79-12-0 on April 6, although no dividend had been paid by the company in the meantime. It then fell to Rs. 32-7-0 in June, 1941, although in that year Rs. 57 lakhs was paid as dividend. The share again rose from Rs. 40-15-0 in June, 1944 to about Rs. 70 in July, 1946, although in the meantime, the dividend had fallen from Rs. 44.5 lakhs to Rs. 38.1 lakhs. The crisis in the share market resulting from the crash in Indian Irons prices in 1937 has already been dealt with (Chapter I). The same scrip played a large part in the crash of August-September, 1946 also. (See Chart C page 90).

Price Fluctuations in the post-war period.

9. Perhaps the effects on price fluctuations of uncontrolled speculation can be seen best in the security prices in India during the nearly two years after the termination of hostilities. This period witnessed successively a sudden boom and heavy slump in share prices. The Economic Adviser's index numbers of variable yield securities rose from 250 in March, 1946 to 315 by August, a rise of 26% in five months, and then the index fell headlong from month to month till it reached 239.3 in February, 1947. After the budget (February, 1947) the fall again became rapid and it stood at 215 in May, 1947.

10. If we take a few individual scrips both the boom and slump will appear more glaring. From the following table can be seen the trend of prices in six active scrips from September, 1945 to May, 1947.

TABLE 3.

| | Bombay Dyeing. (250) 1 | Tata Defd. (30) 2 | Imperial Bank (500) 3 | Indian Iron (10) 4 | Burrakur Coal. (10) 5 | Howrah Jute (10) 6 |
|---|---------------------------------|----------------------------|--------------------------------|-----------------------------|--------------------------------|-----------------------------|
| Sept., 1945 | 1,988 | 2,382 | 2,200 | 41-11-0 | 45-1-0 | 91-10-0 |
| May, 1946 | 2,610 | 3,092 | 2,740 | 57-4-0 | 55-2-0 | 141-10-0 |
| Aug., 1946 | 3,205 | 3,587/8/0 | 3,120 | 70-0-0 | 65-12-0 | 171-8-0 |
| Percentage rise between Sept., '45 and Aug., 1946 | 61% | 51% | 42% | 67% | 81% | 47% |
| Sept., 1946 | 2,865 | 2,955 | 3,130 | 54-13-0 | 52-0-0 | 145-12-0 |
| Feb., 1947 | 2,630 | 2,555 | 2,410 | 43-4-0 | 37-0-0 | 112-8-0 |
| May, 1947 | 1,110 | 1,765 | 2,332 | 30-0-0 | 37-0-0 | 108-0-0 |
| Percentage fall between Aug., '46 and May, 1947 | 65% | 25% | 51% | 57% | 44% | 37% |

11. It can be seen from the above table that between September, 1945 and August, 1946, the prices of these active counters rose from 42% to 81%. Subsequently between September, 1946 and May, 1947 the same scrips slumped from 25% to 65%. Most of these price changes were unconnected with the dividends, profits, or general prospects of the companies concerned. They were largely due to certain extraneous factors and the mischievous use of them by groups of speculators.

12. Various causes have been assigned for both the upward and downward movement in prices. The cheap money policy fostered without any provision being made for it being in productive channels brought about a diversion of vast funds into speculation. As usually happens, this boom went up to giddy heights and a crisis and price decline inevitably followed. At this time came communal riots and political uncertainties, social unrest and labour troubles, and made the investors shy. On top of all this came an unexpected budget and unwelcome tax measures. All these indeed had their effect in stock prices. But this does not tell the whole story. Both the boom and the slump were aggravated by the manipulations of speculators plying for private profit. The upward movement began by the bid for monopoly control by powerful financial groups and was worked up by the mischievous activity of speculators assisted by the ignorance of outside operators. Similarly when the slump came, persistent bear activity, chiefly by stock exchange members, aggravated it. A panic was worked up by propaganda, and availing themselves of this, short-sellers played havoc in the market with their familiar tactics. In other countries, stock exchange authorities take a bold line on such occasions and safeguard the national interest; but in India, stock exchanges exist for their members' benefit, and even those exchange authorities who profess concern for public interest quail from taking firm action when such action injures the private interest of themselves and their members. Nor is there any public authority in existence to remind stock exchanges effectively of the country's interest. In the result, the investing public is being mulcted from time to time, and confidence in corporate investments has been shaken.

Fundamental Weakness of Speculation.

13. All this is evidence of the fundamental weakness of speculation as practised in India. Only well-informed shrewd speculators can evaluate scrips and discharge the important function of forecasting values. Most of the speculators in India, whether insiders or outsiders, have neither the knowledge of facts nor the experience needed for such business. Nor are there suitable agencies to give the information required. Both optimism and pessimism catch easily and are often pushed to unwarranted heights. As a shrewd observer puts it, "with the slightest change of sentiment, lakhs and lakhs of shares are thrown on the market, or taken off the market; an event which ordinarily would have meant only a fluctuation of 4 annas or 8 annas produce a rise or fall of as many rupees." In spite of the catastrophic slump in general prices of the early thirties, the price of British securities (ordinary shares) fell only by one-half. But in India, while the general prices were remaining more or less stationary, security prices (ordinary shares) recorded a 58 per cent rise between September, 1945 and July, 1946, and soon afterwards, best a retreat precipitately. This has happened before, the prices of ten leading securities in 1934 and 1937.

this. The figures of authorized capital are indeed impressive, but not so paid-up capital. It is true that during the five years 1940-1 to 1944-5 (the last year for which statistics are available), the paid-up capital of joint stock companies in British India increased from Rs. 293.0 crores to Rs. 360.7 crores, an increase of Rs. 67.7 crores for five years, or an average increase of Rs. 13.5 crores per year. Having regard to the tremendous increase in the money in circulation and bank deposits (from Rs. 435 crores in 1939 to about Rs. 2,000 crores in middle of 1945—a five-fold increase), this expansion in paid-up capital cannot be regarded as anything startling, seeing that in certain earlier periods, when there was no inflation, larger annual increases of paid-up capital had taken place. No doubt the classes that derive profit from company flotations and stock exchange dealings have put in a part of their large war-time earnings into industries; but there is no indication that the classes formerly given to hoarding their surplus incomes have changed over to industrial investment.

18. On the other hand, there is reason to think that in recent years people who could save for the rainy day have become more reluctant to invest in company shares, and this is due firstly, to the excessive fluctuations in the stock market prices and the heavy losses thereby incurred by those who invest in them, and secondly, to the mischievous staggering operations by which company promoters have been making inordinate profits at the expense of honest investor. In the result, one fears the incentive among the middle classes to invest their savings in corporate enterprise has had a set-back, and judging from the tremendous increase in land values and bullion prices and other indications, it does not appear that any large change in the direction of middle class investment has taken place. This is a situation which must cause serious concern to those (and who is not?) who are keen on raising the living standards of the masses in this country by carrying out a long-term plan.

Effect on Credit System, etc.

19. Wide fluctuations in security prices have their repercussions necessarily on the money market and on the credit system as a whole. This has been illustrated notably in the recent history of the United States. When the price of securities rise, the credit of those who hold securities increase and this is an addition to their purchasing power. That this factor has had some effect on inflation in this country in war time there cannot be any doubt. When, for instance, the total value of shares of 5 Calcutta companies rose from Rs. 11.48 crores in June, 1941 to Rs. 26.03 crores in June 1946—or when the price of an equity like the Indian Irons rose from Rs. 40 in June 1944 to Rs. 70 in July, 1946—there is no doubt that those who own these stocks had a large increase in purchasing power and, although some of the holders may not have realised these extra values, many must have done so and in any case this made a large addition to the total purchasing power, which when pitched against goods in short supply was bound to aggravate inflation. It was on account of this that steps were taken by Government to curb speculations in the stock market, but unfortunately they were altogether inadequate to attain the end in view.

20. In the U. S. A. the stock market boom of 1927-29 culminated in a crash of unprecedented magnitude. It is true that India has not so far experienced such a serious crisis. But this must be due

to the fact that stocks and shares constitute a smaller proportion of the wealth of this country than of America, and also because the proportion of persons engaged in stock and share dealings is also much smaller. Corporate capitalism is still in its early stages in India, and although it has made rapid strides in certain parts of the country and among certain sections of people, the great majority of people in India are still engaged in agriculture and rural occupations; and it is not likely that any crisis in stock markets can lead to such serious developments as happened in America and elsewhere.

Stock Market Crisis and Banking.

21. In Europe and America crises in the stock market have had serious repercussions on the banking system. This is because the banks give large credits for stock market operations and lend freely on stock and bonds as collateral. The consequence is that when there is a crash in stock prices, the security of banks is endangered. Thus the crash in bond prices in the U. S. A. in 1931 resulted in the bank crisis of 1933 which brought about the ruin of 15,000 banks or nearly half the number of banks at the time in that country.

22. In India too, banks have been lending for stock market operations, but such loans are still not a large proportion of the funds used in stock dealings. This is because the funds employed on the stock market are largely derived from private sources. There is evidence, however, that during the last few years joint stock banks in India have been giving advances more freely on shares. It was claimed in 1946, for instance, by the Chairman of the Punjab National Bank that "all banks, big and small, go in for a considerable proportion of their loans and advances against the security of shares." Although scheduled banks' advances against shares had been growing recently, they have not come to be any large proportion of the total advances made by those banks. According to statistics collected by the Reserve Bank of India such advances against shares by 63 scheduled banks amounted to Rs. 49 crores on 24th May, 1946, but the total advances of these banks on the same date amounted to Rs. 371 crores. The proportion of advances on shares to the total deposits was also small. The margin on these advances varied from below 5 per cent to above 50 per cent, but on the bulk of the advances the margin allowed was between 30 and 50 per cent. Considering all this above, the position of the scheduled banks in this respect cannot be considered serious.

23. The non-scheduled banks, however, have been more reckless in giving advances on stocks. What happened in Calcutta in 1946 is perhaps significant. During the war, numerous mushroom banks had sprung up in Calcutta, taking advantage of the cheap money policy. They extended their operations by means of propaganda, excessive advertisements and lavish entertainments on the occasion of opening of branches. A good part of their capital was used in speculative operations on stock exchanges and in some cases liberal advances were made on shares, sometimes without any safety margin. So long as fresh deposits could be obtained from the public, these banks were able to indulge in such reckless operations, but when share prices on the Calcutta Stock Exchange began to slump heavily, in the month of September, 1946, they found it difficult to meet the demands from their depositors. There is a belief that it was partly the abruptness of the Reserve Bank's action that precipitated the crisis. But it must be admitted that the Reserve Bank made

every effort to assist the banks in trouble by purchasing Government securities held by them, but many of them—one of them a scheduled bank—had no eligible paper as they confined themselves largely to advances against company shares. One of the banks was granted moratorium. But in spite of such measures many banks—about 80 of them—had to close their doors.

24. The activities of all banks, especially non-scheduled banks, should be carefully watched in future and accurate statistics should be collected. There may not be any immediate danger, but it is clear that as the Chairman of the Punjab National Bank has stated: "With ill-developed stock exchanges, unlicensed brokers and the gullible public animated with the desire to get rich quick, there is a danger of the spread of speculation mania." All precautions must be taken for keeping such speculative mania under control, and the Reserve Bank can do a great deal in this matter.

Widespread Tax Evasion.

25. Had even a small fraction of the large speculative profits made been going into the public fisc thereby lightening the general tax burden, this might have been some compensation for the heavy losses stock market speculations have inflicted on the public. But this has not been the case, partly owing to the difficulties in the tax machinery and largely owing to the tax evasion skill of the classes engaged in stock market operations. Perhaps in no other country has such skill been attracted to the stock market evidently the game there is not often worth the candle, but in India as the gains have been large, the profession has become popular with a small but influential class, whose rare ingenuity has been systematically used as much for hoodwinking tax-collectors as for deceiving their less wary fellow-men.

26. Tax-evasion from stock market gains may be considered under three heads:—(i) *Contract Stamps*, (ii) *Transfer Stamps* and (iii) *Income Tax*. Contract stamp is an *ad valorem* duty to be paid by affixing stamp to the contract deed to make it legal and valid in the stock and share trade. Colossal tax evasion has been taking place under this item owing to several reasons. No Government machinery has been devised for collecting stamp duties and as matters stand at present, the payment is left to the good will of the traders and their clients. After the promulgation of the D.I.R. 94C, much trade was in the two leading cities diverted from the organised stock exchanges to outside markets, where they are free from the operation of any strict rules. In particular, there was an unprecedented growth of speculative business in the street market and thus a very huge volume of trade completely escaped the stamp duty. Even among the stock exchanges, many being imperfectly organised, it has not been easy to collect the stamp duty from them, their business being almost like that of the street market. As for the well-organised stock exchanges, almost all their trade is carried on between members themselves, and they have cleverly managed to evade the stamp duty by not entering into any formal contracts but by passing memos between them. The system of passing of 'sold' notes and 'bought' notes was devised to avoid the legal execution of contracts, so that the traders may evade the stamp duty. It must be said in fairness to the recognised stock exchanges of Bombay and Ahmedabad that they at first tried to co-operate with the Government by collecting contract stamp duty in respect of the transactions that

passed through their clearing houses. But after the promulgation of the Defence of India Rule 94C, it is doubtful if they have co-operated fully. Even if stock exchanges co-operate fully with Government, it might be difficult for them to collect any large part of the stamp duties seeing that only four stock exchanges (now three) in India maintain clearing arrangements, and even they employ this machinery only for active counters (35 out of 288 listed scrips in Bombay Stock Exchange, 16 out of 116 scrips on the Indian Stock Exchange). Evidently, therefore, a large amount of trade has been escaping the stamp duty. It is a Provincial source of revenue, and it is for Provincial Governments to concert measures for collecting it.

27. **Transfer Stamp:**—Under this head, tax-evasion has been much larger, owing to the wide prevalence of blank transfer throughout the country and the accumulation of such tax evasions has contributed extensively to the inflationary position of war time. As, under blank transfer, securities can be transferred to the vendee, without filling up his name in the transfer deed, it is possible for him (vendee) in turn to sell the same security to another vendee without registration and payment of transfer stamp. This process goes on till the security goes into the hands of a genuine investor or till the stage is reached when the company declared the dividend. Thus, the practice of blank transfer not only aggravates speculation as shown above, but it also deprives the Government of large slices of revenue due, under the Transfer of Property Act. Under that law, for every transfer of stocks and shares from person to person, the Government is entitled to get an *ad valorem* stamp duty, for the recognition in the change in the ownership by the transfer and registration in the company's books. Of the total trade in the stock exchange it has already been stated that not less than 80 to 90 per cent. of the business is speculative and as matters stand today, transfer and registration of securities is not necessary and does not take place till the share reaches a genuine investor or till the company concerned declared the dividend. This practice is in vogue even in the case of short-term investors, such as, banks, insurance companies and other investment institutions, who hold securities among their investments. Cases are not uncommon wherein scrips have been changing hands for a number of years without getting registered by the holders. This latter position is made possible by the practice of some companies paying dividends to the holders of scrips under blank transfer through brokers and banks. That means that shares might be changing hands many times without paying even a single stamp duty.

28. **Income-tax.**—Such tax-evasion is not confined to the Provincial field of revenue. It is equally pronounced in the important Central head of income-tax. The evasion of income-tax arises mainly from lack of auditing of the member-firms by the authorities of the stock exchanges. All the contracts on the exchanges are dealers' contracts. Of these, as shown above, not less than 90% are members' own jobbing which has either a margin of profit or of loss. The chief malpractice reported in this connection, is that by book adjustments and by fictitious entries of transactions with mutual agreement among the parties, the loss side is always kept in excess to escape income-tax. Another method in vogue is the practice to make entries of transactions in different names both in contracts and in books, while the party is the same. Such malpractices have come to light in Calcutta, in connection with certain disputes among brokers in that city. It is also reported that some brokers keep double sets of accounts, one set for the purpose of income-tax and the other set for

their own use. Evasion has become a fine art in India, and highly skilled technical help has been used for it. It is a thousand pities that ingenuity which in Western countries has been largely employed to make technical advances for the welfare of man has in India been lately used for dodging the tax collector and sometimes for deceiving one's fellowmen.

29. After the promulgation of the D.I.R. 94-C, most of the speculative business was diverted from organised exchanges to street markets and to private firms, as shown above, and evasion of income-tax became much easier and more common. Although the turnover of business of the Katni market in Calcutta is believed to be as much as ten times that of the stock exchange, and although it is known that many members of the stock exchange had been operating on the Katni too, only one person in Calcutta, according to the Income-tax Commissioner had declared an income from this line of business for assessment. Such was the extent of evasion in the matter of income-tax, at a time when share dealings had assumed large proportions and huge incomes had been made on them. In fact, it is the ease for tax-evasion that tempts a large number of persons to engage in stock-speculation.

The Outcome.

30. Thus, the operation of the Indian security markets has had unfavourable results on public economy as well as on private. The large volume of uncontrolled speculation coupled with frequent interference with the free play of supply and demand by manipulative forces have led to wide fluctuations of prices and have had serious repercussions on the credit structure. The stock market has failed to provide safety for and equity in dealings and has not proved an effective agency for the direction of the nation's savings into the most productive channels. Such a disorganised condition of the stock market has also brought about widespread tax evasions under various heads.

31. As has been shown above, this state of things is largely due to the recent development of the unorganised stock market, namely, the street markets and independent firms. Owing to lack of regulation of their operations, a great part of the securities trade has gone into the outside markets. The intrusion of these unregulated markets has done great harm to the national economy. But even among stock exchanges a large number have been operating without any definite rules or practices. A few stock exchanges are indeed working under detailed rules and regulations, but even they have not been able to enforce those rules effectively. The rules of an institution may be perfect, but of what avail is it, so long as those rules are not carried out in practice? How is it that the Indian security market is still remaining in such a chaotic condition? In my opinion, three fundamental factors are responsible for it, namely: (i) lack of experience and training among the great majority of members of the stock exchanges, (ii) a general craze for speculation and gambling in the country and (iii) continued indifference of the Central Government to safeguard public interest in this important matter.

32. There is no doubt that among the members and office-bearers of our leading stock exchanges there are several men of great financial shrewdness and integrity of character. But the business standards of the great majority are extremely low. Mr. A. D. Shroff, after twelve years' experience as a stock broker stated: "I am

constrained to admit from experience the truth of what Dr. Johnson once said that stock exchange is the last refuge of a desperate man. . . . Many of them (brokers) are quite misfits and should be considered entirely unequipped for the business of a stock broker." Most of the members of the stock exchanges do not get proper training before taking up this profession. Any man of means could purchase a card or a share of the stock exchange without any previous experience to his credit. Membership is also partly hereditary. No educational standards are insisted on. Membership of a stock exchange carries with it heavy responsibilities, but it is too much to expect such people to fulfil these functions properly. With the majority of the members in this condition, it would be an extremely difficult task for the managing board to maintain standards and enforce rules and regulations.

33. The more fundamental cause is that the craze for speculation and gambling has been too powerful in this country. For ages, certain classes in the country have utilised their intelligence and acuteness for devising the cleverest methods of gambling, and, thanks largely to the introduction of an alien legal system favouring the survival of the fittest, they have outwitted the law courts and have been able to amass large fortunes without putting forth much labour of a really productive kind. When people could easily make such fortunes by speculation and gambling, what incentive is there for them to engage in the more hum-drum, and often risky, work of production? Those who have tasted the fruits of gambling will never give it up, especially when public opinion tolerates it. In this way some of the brainiest people in the country have been devoting their energies to take the bread out of the mouths of their fellowmen. It is these classes mostly that utilise the security market, whether as brokers on the stock exchanges or as independent dealers plying curb markets or doing over-the-counter trade. Latterly, outsiders have also been drawn into it by the lure of easy profit and many of them have sedulously followed the example of the professionals. Some have indeed lost heavily, but all the same the mirage of easy profit is still haunting them. In this way, not only in Bombay and Calcutta but also in mofussil towns, large number of people have been caught up in this whirlwind of speculation.

34. It is true that some of these classes have lately taken to industry. But one has reason to doubt if what attracted them is the legitimate profit accruing from the efficient production of some commodity (as the case is with industrialists in the more advanced countries). Or, is it too often the chance of making doubtful gains by financial jugglery of the kind described earlier in this Chapter? Pandit Jawaharlal Nehru threw out a significant idea in his speech at the Associated Chambers of Commerce at Calcutta in January 1947: "Most of our industrialists," he said, "are hardly industrialists; they are financiers. They were buying up industries here and there, but there was hardly any industry about that." In fact, this is the very keynote of the economic history of India in recent times, and this largely accounts for the industrial backwardness of this country. This also partly explains the decline of production after the war. While the war was on and profits were large, they went on producing somehow; but with no such large profits assured they are looking for other ways of easy money making. Promoters of companies, as shown above, are most interested in the profits they could carve out by 'staggering' shares, but when it comes to hum-drum production, their interests seem to flag. Such things have been tolerated in this country, owing to the lack of a strong public conscience. There is only one

92

way to attract these people to their legitimate occupation, and that is to make such financial jugglery difficult and shameful—difficult by setting up a competent authority to supervise such activities, and shameful by rousing public conscience against it. Fortunately, the radical change in the political status of India has made such an assertion of public right easier than in days when under the uncontrolled sway of *laissez faire* the rich were enabled to get richer and the poor left to remain poor.

APPENDIX A*

INDEX NUMBERS OF SECURITY PRICES:
U. K., U. S. A. and INDIA.

| Month and Year. | U. K. | | U. S. A. | India. |
|-----------------|--------------------|--------------------------------------|----------|--------|
| | Base: 1924=100. | As percent- age of Aug., 1939. | | |
| 1 | 2 | 2A | 3 | 4 |
| 1939 | | | | |
| August .. | 118 | 100 | ... | 100.0 |
| September .. | 106 | 89 | ... | 122.4 |
| October .. | 104 | 88 | ... | 125.6 |
| November .. | 106 | 89 | ... | 144.1 |
| December .. | 105 | 89 | ... | 149.5 |
| 1940 | | | | |
| January .. | 104 | 88 | ... | 135.0 |
| February .. | 106 | 89 | ... | 132.2 |
| March .. | 109 | 92 | ... | 131.9 |
| April .. | 106 | 89 | ... | 132.8 |
| May .. | 97 | 82 | ... | 125.9 |
| June .. | 82 | 70 | ... | ... |
| July .. | 79 | 67 | ... | 121.3 |
| August .. | 84 | 71 | ... | 118.7 |
| September .. | 87 | 74 | ... | 118.8 |
| October .. | 91 | 77 | ... | 122.1 |
| November .. | 97 | 82 | ... | 126.2 |
| December .. | 95 | 81 | ... | 128.8 |
| 1941 | | | | |
| January .. | 98 | 83 | 85 | 128.7 |
| February .. | 96 | 81 | 80 | 130.6 |
| March .. | 92 | 78 | 80 | 131.5 |
| April .. | 93 | 79 | 78 | 122.4 |
| May .. | 93 | 79 | 77 | 125.6 |
| June .. | 96 | 81 | 80 | 132.8 |
| July .. | 102 | 86 | 83 | 139.7 |
| August .. | 107 | 91 | 83 | 142.8 |
| September .. | 109 | 92 | 84 | 156.1 |
| October .. | 107 | 91 | 80 | 158.4 |
| November .. | 109 | 92 | 77 | 178.6 |
| December .. | 110 | 93 | 72 | 149.8 |

* (See Chart A)

| Month and Year. | U. K. | | U. S. A. | India. |
|-----------------|--------------------|--------------------------------------|----------|--------|
| | Base: 1924=100. | As percent- age of Aug., 1939. | | |
| 1 | 2 | 2A | 3 | 4 |

1942

| | | | | |
|--------------|-----|-----|----|-------|
| January .. | 112 | 95 | 73 | 146.5 |
| February .. | 107 | 91 | 70 | 141.1 |
| March .. | 105 | 89 | 66 | 140.0 |
| April .. | 106 | 89 | 63 | 137.6 |
| May .. | 107 | 91 | 63 | 139.5 |
| June .. | 111 | 94 | 66 | 143.2 |
| July .. | 109 | 92 | 68 | 145.3 |
| August .. | 111 | 94 | 68 | 146.8 |
| September .. | 115 | 98 | 69 | 157.1 |
| October .. | 120 | 102 | 74 | 162.4 |
| November .. | 126 | 107 | 75 | 170.3 |
| December .. | 126 | 107 | 76 | 167.4 |

1943

| | | | | |
|--------------|-----|-----|----|-------|
| January .. | 131 | 111 | 80 | 170.9 |
| February .. | 132 | 112 | 85 | 176.3 |
| March .. | 132 | 112 | 88 | 187.0 |
| April .. | 133 | 113 | 91 | 198.2 |
| May .. | 134 | 114 | 95 | 194.9 |
| June .. | 132 | 112 | 97 | 204.0 |
| July .. | 133 | 113 | 99 | 193.0 |
| August .. | 140 | 119 | 94 | 194.4 |
| September .. | 142 | 120 | 96 | 202.6 |
| October .. | 141 | 120 | 95 | 212.8 |
| November .. | 134 | 114 | 91 | 216.9 |
| December .. | 137 | 116 | 92 | 214.8 |

1944

| | | | | |
|--------------|-----|-----|-----|-------|
| January .. | 139 | 118 | 95 | 232.2 |
| February .. | 141 | 120 | 94 | 228.2 |
| March .. | 140 | 119 | 97 | 229.7 |
| April .. | 141 | 120 | 95 | 225.1 |
| May .. | 145 | 123 | 97 | 231.9 |
| June .. | 152 | 129 | 102 | 241.7 |
| July .. | 156 | 132 | 104 | 247.8 |
| August .. | 157 | 133 | 103 | 242.5 |
| September .. | 151 | 126 | 101 | 228.1 |
| October .. | 151 | 128 | 104 | 235.0 |
| November .. | 154 | 131 | 103 | 239.6 |
| December .. | 154 | 131 | 105 | 243.9 |

| Month and Year. | U. K. | | U. S. A. | India. |
|-----------------|--------------------|--------------------------------------|----------|--------|
| | Base: 1924=100. | As percent- age of Aug., 1939. | | |
| 1 | 2 | 2A | 3 | 4 |
| 1945 | | | | |
| January | 157 | 133 | 108 | 247.7 |
| February | 156 | 132 | 113 | 243.8 |
| March | 157 | 133 | 112 | 242.4 |
| April | 159 | 135 | 114 | 240.0 |
| May | 157 | 133 | 118 | 241.0 |
| June | 151 | 128 | 121 | 248.0 |
| July | 158 | 134 | 118 | 267.8 |
| August | 152 | 129 | 118 | 253.7 |
| September | 154 | 131 | 126 | 253.9 |
| October | 156 | 132 | 132 | 256.5 |
| November | 161 | 136 | 137 | 269.4 |
| December | 155 | 131 | 140 | 294.3 |
| 1946 | | | | |
| January | 158 | 134 | 145 | 288.8 |
| February | 159.5 | 135 | 143 | 287.1 |
| March | 160 | 136 | 142 | 309.1 |
| April | 165 | 140 | 152 | 322.8 |
| May | 173 | 147 | 154 | 345.3 |
| June | 179 | 152 | 153 | 357.7 |
| July | 179 | 152 | 150 | 399.9 |
| August | 176 | 149 | 146 | 399.2 |
| September | 171 | 145 | 125 | 356.7 |
| October | 164 | 139 | 122 | 340.6 |
| November | ... | ... | ... | 320.2 |
| December | ... | ... | ... | 316.9 |
| 1947 | | | | |
| January | ... | ... | ... | 318.2 |
| February | ... | ... | ... | 298.1 |
| March | ... | ... | ... | 286.9 |
| April | ... | ... | ... | 274.0 |
| May | ... | ... | ... | 267.3 |

Note:—

U. K. Source: 'London and Cambridge Economic Service' Bulletin. The figures relate to industrial shares, the base being 1924. In column 2A is given percentage of August, 1939 index.

U. S. A. Source: Federal Reserve Bulletin. The figures relate to common stock prices (including industrial, railroad and public utilities) and the base is 1935-39=100.

INDIA. Source: 'Capital' Stocks and Shares index. The figures relate to the variable-yield securities, the base being 1939 August=100.

Although these figures are not strictly comparable, the base years being different, they give a rough indication of the general trend of security prices in U.K., U.S.A. and India during the period 1939 August to 1946.

CHAPTER VIII.

SHOULD THE STOCK MARKET BE REGULATED ?

1. It has been shown in Chapter V that the working of the stock market in India has resulted in frequent outbreaks of uncontrolled speculation coupled with interference with the free play of supply and demand by manipulative activity. These have not only made it difficult for the stock market to function satisfactorily, but have had also serious repercussions on national economy as a whole. It now remains for us to suggest remedial measures.

Abolition of Stock Exchanges ?

2. According to one school of opinion, the remedy for this is to abolish all stock exchanges, or in the alternative, to abolish all speculation and confine the stock market to investment transactions only. As shown in Chapter IV, in the stage of capitalism at which we have arrived, capital has to be accumulated mostly by corporate enterprise, and if such enterprises are to function efficiently, their securities must be freely transferable. By closing the stock market, we will not abolish all speculative dealings in stock, because, so long as human nature remains what it is, the inclination to speculate and gamble will also remain. There is only one way for stopping stock speculation altogether ; and that is to abolish the system of private property and adopt full-fledged socialism or Sovietism. So long as this is not done, the right policy will be to bring speculation under control, as has been done more or less successfully in several countries.

3. To abolish all speculation on the stock market and to confine dealings to pure investment is not practicable. Only by having a large number of dealings in shares can a "free market" be created, and then only can corporate enterprises flourish. This will not be the case if pure investment alone is allowed. It is true that speculation is liable to degenerate into gambling which causes serious evils. But on this ground to give up speculation is not wise. As Mr. Otto H. Kahn points out : "The speculator has a useful and probably a necessary function ; the gambler is a parasite and a nuisance. He is tolerated only because it seems impossible to abolish him without at the same time doing damage to elements the preservation of which is of greater public importance than its obliteration."

4. Further, it is very difficult to draw a line of demarcation between speculation and gambling ; it is difficult to say where speculation ends and gambling begins. If properly regulated, speculation can render a necessary service, as has been shown in Chapter IV. If speculation is carried on under the rules and practices of a well-organised stock market, it can perform these services efficiently, and could greatly help the process of capital formation which is most important, especially for an under-developed country like India. Nor is it wise to do away with all speculation on the ground that it is liable to degenerate into gambling ; this is almost like destroying a valuable forest, because it harbours poisonous snakes. As Van Antwerp says : "The free speculative market is in itself an element of value, and if it is destroyed the investor would be chiefly injured, while the capitalization for the development of the country would be reduced." If speculation has such uses, there is no reason to have

to be discipline for its proper use and society has a duty to see that provision is made for speculator not being misused.

Regulation—An Invasion of Private Right ?

5. The abolition of the stock market or even the total elimination of speculation being out of the question in the existing social order, some kind of regulation of that market must be considered essential to see that the stock market fulfils its proper functions. Various objections have been urged against Government interference. The very right of Government in this matter is questioned on grounds of orthodox theory. Stock Exchanges, they say, being "a commercial body, Government interference in its working is an invasion of private rights." Some have stated that such interference is not only undesirable, but even dangerous. There is a serious misapprehension behind this argument. Those who urge it forget (or perhaps do not realise) that stock market dealings unlike most other trades are vitally connected with the banking system and the credit structure as a whole. Its intimate connection with the price structure and the long-term capital market has also to be taken into account.

6. It has been explained in Chapter V how the stock market affects the safety of banking and how in the U. S. A. the collapse of bond prices in 1931 led to the closing down of half the total number of banks and how even in this country over a hundred banks in Calcutta alone were in trouble by the débâcle in stock prices in the latter half of 1946. It is not only the decline in security values that are affecting the banking system and the credit structure. When stock prices boom, credit also is made to expand by the vast demand from traders and this is one of the serious inflationary factors which have to be taken into account. In the U. S. A. such conditions proved fatal in 1928-29 and although conditions have not got so bad in India, they have often been bad enough and it is wise that precautions should be taken in time against their becoming worse, in the public interest.

7. It may also be remembered that the endowed institutions of a country—schools and colleges, hospitals, places of worship, charitable institutions, etc.—have a special stake in the prices of securities, because a good part of their endowments are invested in securities. Therefore, any collapse in share prices leads to dislocation of such important national institutions on which the lives of millions of people depend.

8. The intimate connection between stock markets and general business condition must also be taken into account in this connection. Stock markets are now rightly considered as a barometer of business. Some even claim that this market has a causal effect on the economic weather. The extent of such influences is still a matter of doubt, but it cannot be denied that the stock market is a vital factor in business activity and "a powerful influence both as a depressant and as a stimulant of business activity in general."

9. It is essential, in the best public interest, not to leave entirely in private hands an economic institution which is intimately connected with our banking system and so closely intermeshed with the gears that drive the wheels of our industry and commerce. The following conclusion was arrived at by the Research Staff of the Twentieth Century Fund in 1933 after an elaborate study of the American security market:—"To allow the machinery which regulates this vital function to be operated as the private property of self-interested persons subject to little effective check other than public opinion,

creates a preposterous situation which should not be allowed to continue." It is for the people to say what function they want the stock market to perform and in what manner it should be performed.

10. If it is granted that the stock market should be properly controlled in the public interest, the question then arises as to who should control it. Chief among those who are concerned with its working are issuers and buyers of securities (investors and speculators), banks and lenders who finance those dealings, and finally brokers and dealers who work as agents of those who buy and sell. In view of such multiplicity of interests, it is not fair that the control of this stock market should be left entirely in the hands of one section among them. In actual practice the control of stock exchanges has come into the hands chiefly of speculators who earn a living by turning to quick profits the fluctuations in prices which they themselves bring about. This class, according to many, are "the very last of the whole series or groups to be set up as a governing bloc." Is it in the national interest to leave the control of stock exchanges entirely in such hands? Whoever may be working the stock market, it is for the people of a country to say what functions they want that market to perform, and in what manner those should be performed. Viewed in this light the claims of State legislation and Government supervision stand on unassailable grounds.

11. The importance of the stock market in the national economy of a country and the propriety of it being regulated by the National Government has nowhere been more forcibly brought out than in the U. S. A. In respect of stock exchanges, the Congressional Committee in the U. S. A. has stated that "their results are as broad as the business interests in the country, and affect in their most intimate and important business relations of all people thereof." A keen critic of the exchanges referred to the New York Stock Exchange as "an integral and inseparable part of the national financial system, as important as any part of the whole system, as important as the banks themselves" and stated that "its quotations are taken by banks all over the country as a basis for loans on securities. Courts of justice in every section figure their damages on the quotations of the New York Stock Exchange. These quotations constitute evidence of value." This same argument applies equally strongly to stock market in India.

Ineffectiveness of Government Control.

12. Another line of criticism is that the stock market cannot be effectively controlled by Government. It is true that in the past unsuccessful attempts have been made in many countries to stop various forms of speculation like short-selling, and if such experiments did not succeed it was because some of them were ill-conceived and badly administered. There is no doubt that Government in those days had little equipment for such work. It is true that the usual Government departments are even today ill-equipped for a proper regulation, partly by lack of expert knowledge and partly because of the habitual delays of Government departments. That Government could equip itself for performing such work efficiently has been demonstrated by the U. S. A. where a permanent Commission assisted by an expert staff is now functioning. The work of this Commission during the last twelve years gives the lie direct to all facile taunts regarding Government's incapacity to supervise such a complicated thing as the stock exchange.

13. But there are still people in India who will not take note of this. They still quote *ad nauseum* from the writings of J. E. Meeker, who was economist of the New York Stock Exchange in the days when that Exchange fought hard against stock market control by the Federal Government which was then being pressed by a growing public opinion in America. They also quote from the antiquated memoranda of certain members of the British Royal Commission of 1867. Since then, much has happened in both the U. S. A. and the U. K. The New York Stock Exchange has got completely reconciled to Federal regulation and is working very amicably with the Government Commission concerned, although a thorough reorganisation of that exchange had to be carried out, at the instance of the Commission. In the U. K. too, the intervention of the Board of Trade in the stock market has had to be greatly increased in recent years, and if in the matter of the London Stock Exchange, the intervention has not gone to the extent of the U. S. A., it is because that Exchange has by long and bitter experience learnt to discipline itself and act in conformity with the highest public interest. Those who quote British practice in support of their views must not forget the material difference of environment—social and economic—between the U. K. and this, or any other country for that matter.

Stock Market Control will hit Industry ?

14. Stock market control has also been disapproved by certain organisations on the ground that it would prove injurious to the development of industry. For instance, the Indian Chamber of Commerce, Calcutta, in their memorandum, states that any attempt at regulating the stock market is inopportune. "considering the undeveloped state of India's economy." "India," it is pointed out, "is still in a state of infancy in regard to her development of industries, and considerable capital is yet required to expand its industrial resources. Any measure that is prejudicial to the free acquisition and growth of industrial capital should not be adopted in the present state of India." Thus, it is contended that the investment habit will be hampered by Government regulation of the stock market. On the other hand, it must be clear from the facts recounted in the course of this chapter that the stock market as it now functions has not been serving the best interests of long-term investment. Serious losses have been repeatedly incurred by persons investing in the shares of companies, partly by the irresponsible conduct of many members of stock exchanges and partly by fraudulent practices carried out chiefly by outside brokers. The growing anti-social activities of manipulators and their violent interference with the forces of supply and demand have conclusively demonstrated that things could not be set right by regulation undertaken by the stock market alone. Therefore, regulation by a high-powered authority has become essential in the public interest, and only thus could long-term investment be protected and encouraged. Conditions have come to such a pass that intervention by Government has become essential in the public interest.

15. As for the repeated contention that stock market control is premature considering the undeveloped state of India's economy, one may invite the Indian Chamber of Commerce to study the experience of Japan in this matter. In 1893 Japan was industrially not in a much more developed state than India then, and the first stock exchange in Japan had started only in 1878. Yet, firmly bent on ensuring a healthy growth of investment, the Government of Japan

instituted a very strict system of regulation as early as 1893 and strengthened this regulation further in 1914. (See Chapter IX). It may here be pointed out that the control instituted in Japan is much more rigorous than any form of regulation that is being recommended in this report. Yet Japan had a phenomenal economic development since then and became one of the greatest industrial nations of the world. Rather than stock market control hamper investment in Japan, it clearly gave a positive encouragement to investment in industries and trade and thus built up the economic prosperity of that country.

Stock Market Favours Control.

16. It is noteworthy that the authorities of our stock exchanges have lately shown keenness about some regulation being introduced into the stock market. What they want, it is true, is that Government should place some check on their competitors—other stock exchanges and the over-the-counter market—from whom they have lately got much trouble. Often their complaints smack of the inclination to pull out the little mote from the other fellow's eye while a big beam is in theirs. We have to view this question from the national point of view and not with a view to enabling certain sections of the market to obtain a monopoly so that they may indulge in speculation all the more effectively, and more profitably to themselves. We are familiar with such special pleading in other fields, and should be guarded in our action. It could be easily demonstrated that some of the steps they plead for will ultimately prove to their own detriment.

17. Bitter complaints have been made from certain centres regarding the unfair competition from neighbouring stock exchanges. Thus one of the older exchanges complains that the younger rivals in the town, not being under the same strict rules as itself, have been unfairly competing with it by under-cutting in regard to brokerage commission and even by allowing in their premises questionable business like gambling in differences. It is also alleged that the rival stock exchanges allowed forward dealings while the war-time ban was on, thus taking away the business from the exchange which strictly conformed to the ordinance. These are serious allegations which no Government can ignore.

18. Even more severe strictures have come from stock exchange authorities regarding the unfair competition methods and mischievous manipulative practices pursued by many outside dealers. The Atlay Committee condemned them as 'a nuisance and a danger to the public' and wanted that they should be suppressed. The Bombay Stock Exchange authorities, speaking of the nefarious operations of syndicates implore that the "the secretive burglar should be hauled up." "Transactions such as these," they wrote in 1937, "must be banned by legislature as is done in the United States." Government, they aver, must also control the mischievous activities of company directors and agents who are able to carry on speculation more effectively, and to the serious injury of the investing public.

19. The stock exchanges are naturally eager that the outside markets that compete with them must be suppressed. No doubt the unfair competition must be done away with. But, for this it is not necessary to suppress them. If they are prepared to work under proper regulation, they can be given a field for their operation without their butting into the field of stock exchanges. Outside brokers, or the over-the-counter firms, are still carrying on a vast business in

the U. S. A. without causing any injury to the stock exchanges. So they do in London, although to a lesser degree. But this was only possible after the Securities Exchange Commission in the U. S. A. and the Board of Trade in the U. K. cleansed the Augean stables with a firm hand. Only by similar action here could a proper over-the-counter market be created out of the present predatory stock jobbers.

Stock Exchanges also must be brought under Regulation.

20. While the stock exchange authorities are keen about Government keeping a strict control over street markets and outside brokers, they desire that they should be left free to carry out their avocations as it suits them. One can understand such a desire, but cannot appreciate it very much. On the admission of the stock exchanges themselves, there are serious blemishes not only in their constitution but in their method of working. The stock market, as now constituted, cannot regulate itself properly even for securing its own narrow ends; even the organised stock exchanges have shown their incapacity to work together for securing their own ends. How then can they secure to the investors and the public those important interests which it is their right to secure from the stock market?

Firstly, the existing stock exchanges cannot prevent competitors springing up in the same town, even in the same street. The results of such freedom have been amply demonstrated in the last few years. Only Government regulation can set right this evil, which is now much felt by the stock exchanges.

Secondly, even between stock exchanges in the various cities of the country, uniformity of rules in regard to the conduct of business is essential if the stock market is to function in the best interests whether of the exchange members or of the public. Stock exchanges in India, as is well-known, are working at very different levels of organisation, some with fully written and adequate rules, others with only partly written and very inadequate rules, yet others with no written rules. Some are hardly distinguishable from street markets. A few of the exchanges have fairly strict listing regulations, others have practically none. It is in the best interests not only of the exchanges, but of the public, to have uniform rules of business throughout the country, and only Government can effectively see to this.

Thirdly, it is not enough to have proper rules for dealings between members; it is also essential that those rules should ensure equity between members and their clients, between exchanges and the public generally. It has been explained in Chapter VI (para 2) how most stock exchanges in India have made no provision for adequate protection to the public in their dealings with their members, and how serious evils have resulted from this. Even on the two stock exchanges which have made some provision for this in their rules, things have not been well enough. Even in the U. S. A., where exchanges have been more careful in this matter, Government had to intervene, and elaborate rules have been drawn up under the Securities Exchange Act, 1934, for regulating the thirty-seven relationships in stock exchange dealings—between buyers, sellers, lenders, etc.

Fourthly, nor is it enough to have the most perfect and up-to-date rules copied from London and New York; they must also be enforced effectively. Laxity in enforcement of rules has been a serious cause of the evils of our stock exchanges, even the biggest among them. This is too well known and admitted. It is necessary to see that proper rules are not only made but enforced in an institution which

is vitally connected with the banking and credit system of the country, "so intimately intermeshed with the gears that drive the whole industry and commerce of the country." Only Government could discharge this heavy responsibility to the public. To leave it as the private property of self-interested persons would be a serious dereliction of Government's duty.

Fifthly, any such regulation of the stock market will not be effective (as shown in paras 63-64 of Chapter VI) without controlling the dealings in their own stock by directors and other officers of companies and also the activities of company promoters and underwriters; in other words, the sphere of control of any authority regulating the stock market must extend to company law and capital issues, i.e., the whole investment market.

Government's Responsibility regarding Price Fluctuations.

21. The above are essential responsibilities of Government, and are so recognised especially in countries where, as in India, many stock exchanges and outside markets ply in a large country. But in the present conditions of India, Government has to go further and see that the tendency to wild fluctuations in stock prices which has been long pronounced in India must be effectively counteracted by suitable action. It has been shown in Chapter VI above how speculators and syndicates of them have been taking advantage of booms and slumps to make unfair gains by deliberately rigging up or depressing prices, often working upon human sentiments. The twelve months between April, 1946 and May, 1947 have witnessed a great deal of such manipulations, and their memory must be still fresh in the public mind. The bid for monopoly control by powerful financial interests had its part in exaggerating the boom of the mid-1946; likewise the powerful bear activity especially in Bombay had a great deal to do with the landslide in prices in May, 1947. No doubt prolonged political uncertainty, ugly communal squabbles and a bitter pessimism about the future had much to do with it, but these factors were used to capital advantage, in sheer self-interest, by the unofficial market in Calcutta and by the powerful speculative gangs of the Bombay market. It was for the stock exchange authorities to counteract such anti-social activity, but they found themselves ineffective in going against the self-interest of the great majority of their members, including themselves. The Calcutta Stock Exchange fixed minimum prices for some of the active counters, but those prices did not become effective owing to lack of co-operation from other stock exchanges, even from its own members who also operate in the Katni market just outside the stock exchange. In the meantime, as bear-selling activity went on unremittingly, prices of scrips were pushed down to unconscionably low levels, and large gains were reaped by those wicked speculators at the cost of the investing public. One wonders if these individuals are any better than the vultures that gorge human carcass when, in times of cholera or plague, streets are strewn with dead bodies.

22. If any Government regards such anti-social behaviour with equanimity, then one wonders whether Government has a real *raison d'être*. It is the clear duty of any Government worth the name to protect the investing public from such speculators in shares by every possible means. This is not merely out of pity for the investing public but in the wider interests of the country. It is also necessary because the crux of all economic planning is capital development and this

is only possible by encouraging savings. When the investor is allowed to be so shabbily treated by institutions which work under the protection of the law, is it any wonder if he rushes to the bullion market (note that in May, 1947 gold prices rose to great heights), or pushes up the price of land by competing with cultivators who are thus constrained to become landless labourers?

23. Could the Government do anything effective in this line, and if so, how? It is not claimed that Government could stabilise the prices of securities. This is neither possible, nor is it desirable even if possible. But Government could help to maintain prices within a certain range by prescribing and enforcing suitable ceiling and floor, when occasion calls for the same. When prices rise beyond a reasonable level manipulations must be vigilantly watched, and further price-rise must be discouraged. On the other hand, when prices are pushed down by persistent bear-selling the investor must be encouraged to buy boldly and the bear-seller must be caught dripping. The existence of proper investment trusts guided by competent men and subject to state regulation would be a great help in carrying out such plans. Even in their absence, much can be done to give heart to investors by allaying their unreasoned fears in times of panic. Regulations can also be made for controlling the sphere of short sales, as has been done in the U. S. A. But, for carrying out such a plan, no existing Government department is competent; a high-powered authority fully equipped with the necessary knowledge, as in the U. S. A., will have to be created for this, and the effort is well worth the cost.

24. There are indeed persons still who doubt the wisdom of interfering with the forces of supply and demand. Leave it to the market, they say, to determine its prices. For normal times, indeed, this is the only wise course. But are not the forces of supply and demand subjected to powerful manipulations in critical times? Have not the speculators worked up to their advantage, mischievous hopes at one juncture and unjustified fears at another? After all, have investors in India got any authoritative source of market information in order that they may know the true position of concerns? If some public authority will at least provide such information to guide the investing public, it would be a blessing. But it can go further and safeguard the forces of supply and demand from the step-motherly care given to them by seamy speculators. What has been done in the U. S. A. by the Securities and Exchange Commission gives ample justification for this hope.

25. Let it be clearly understood that this is not usurping the price-determination function of the stock market, but safeguarding the market from extraneous influences so that it may fulfil its function properly. Even the President of the Bombay Stock Exchange, who is a stout champion of stock market autonomy—even of the sanctity of its price-determining function—admits that there are occasions when interference is needed. "Of course," he says, "minimum prices have their use, for in an emergency they act as a tourniquet which prevents the life-blood of the market from ebbing away. When unforeseen circumstances threaten the price structure with collapse, fear and panic are rife and presence of mind and cool collected thinking are thrown to the winds, as investors, speculators and operators all combine to act in one direction by wishing to sell out other holdings 'at the best available.' At such a moment fixation of minimum prices, like suspension of trading, raises a dam which stops a run-away market and imparts to it a sense of stability and equilibrium by

providing a breathing space for mobilization of courage and sanity of outlook." Did not an occasion for this arise during the few months, before June, 1947, when 'by fear and panic' and by continued political uncertainty, 'the life-blood of the market was ebbing away? Was it not then necessary not only to fix minimum prices at least for the most active scrips, even to threaten a suspension of the forward market? The President of the Bombay Stock Exchange indeed reminded Government of the gravity of the impending situation, by a strongly worded telegram to the Vice-President of the Interim Government, but the political situation made it difficult to take any effective measures. If the worst fears of the Stock Exchange President did not materialise, it was due not to anything done by his exchange or by other exchanges but because the uncertainties were calmed by the welcome political settlement arrived at by the party leaders of the country under the lead of the Viceroy.

26. To those who doubt why stock market prices should be so jealously guarded while most commodity prices are not, a reference may be made to paras 6 to 10 of this chapter, where it has been shown that fluctuations in stock market prices affect seriously the banking and credit system of the country, and that they concern large numbers of people through the various endowed institutions—schools, hospitals, charitable institutions—which invest their resources largely in securities. Not only the interest of the investing public but of the national economy as a whole demand that the stock market should be guarded from nefarious influences and be helped to work in such a way as to discharge those important functions expected of it.

Ultimate Aim.

27. Our ultimate aim must indeed be to place the responsibility for regulation fully on the stock exchanges themselves. But in the present chaotic condition of the stock market, authorities of the exchanges are helpless in rectifying things, without the active intervention of Government through a competent authority. As the reorganisation proceeds, the exchange authorities will themselves be able to manage without external intervention and the work of Government in this field will taper off. But the pace of such progress will depend on the alacrity with which Government carries out its initial task.

Government Regulation tried in Bombay since 1926.

28. As mentioned in Chapter I, the Government of Bombay made early attempts at regulating stock exchanges by passing the Bombay Securities Contracts Control Act (1926). But this Act is very defective and has not produced the good that was expected. Firstly, the scope of the Act is limited to transactions other than ready delivery contracts. Such inadequate powers of control were not calculated to make Government regulation effective or useful. Secondly, there was no precision even regarding the circumscribed powers of control assumed by Government. The ready delivery contract itself was not properly defined, as has been shown in Chapter IV, and this also made the Government's powers vague and ineffective. Thirdly, under the Act, violation of any rules made the contracts only void, not illegal. As there is no penalty attached to violation, the law could easily be evaded, as it actually has been. Fourthly, the prescribed mode for exercising Government control was unsuitable and even

harmful. Rules of stock exchanges including additions to and alterations thereof must be approved by Government. But such approval could be given only after the lapse of a month after publication in the gazette. This prevented urgent action being taken in emergencies. Powers assumed by Government were vague in many ways and although Government has power to withdraw recognition from the stock exchanges, such a clumsy weapon is not of much use. In the result it has not been possible for Government to exercise any real control even over the two recognised stock exchanges, and there was nothing to prevent new stock exchanges from springing up and working in defiance of this law. And this is what happened.

29. The Morison Committee, in 1937, suggested certain essential modifications in the regulation, but no substantial part of it has yet been given legislative sanction. The Government of Bombay had a bill in readiness in 1939 for regulating stock exchanges as also bullion and other commodity exchanges, but on the outbreak of war, the party (Congress) that prepared the bill went out of office and legislation was shelved. This bill has lately been revived and is now before the Bombay Legislature.

Ineffectiveness of War Time Control.

30. As shown in Chapter I, bucked up by the tremendous increase in the money income of certain classes in war time, numerous stock exchanges and outside firms sprang up in cities like Calcutta, Ahmedabad and Lahore, and a large increase of stock dealings took place in these unorganised and unregulated Markets. When speculation in commodities was controlled as an anti-inflationary measure, money fled into the stock markets. The D. I. Rule 94C sought to regulate this by the ban placed on forward dealings in the stock exchanges, but this did not kill such dealings; they were only driven out from regulated to unregulated markets, and hence the colossal proportions into which the Katni market and other curbs, and outside firms grew, to the great detriment of regulated and recognised places of trade. Of course, there was nothing to prevent the very members of regulated exchanges from carrying on forbidden transactions in outside markets. Thus law was set at naught, Government's revenue claims were trampled under foot. The D.I.R. has lapsed and the conditions are what they were before 1943, except that moral standards in the stock market, never very high, have greatly deteriorated. This was demonstrated in the stock market boom worked up by the reckless speculators in the middle of 1946 and which seriously menaced the safety of the banking system besides causing considerable losses to genuine investors.

Need for regulation still exists.

31. There is no doubt, that during war time a stricter regulation of the stock market should have been carried out in India, as it has been in countries like the U. K. and Australia. The result of inadequate action in this field can be studied on Chart A facing p. 86 which shows the trend of stock prices in three different countries. Had a proper regulation been undertaken, the post-war boom and debacle might have been more efficiently controlled, if not avoided. But to go further and argue that the time for regulation is now past, does not appear convincing. No doubt the stock market is for the moment in

a rather chastened condition, and the volume of transactions is also down; but this may change with settled political conditions, and especially if any economic plan is launched, there may again be unbridled speculation and over-trading. Therefore, the present may be the right time for devising methods of control for the future, for reorganising the stock market and its various sections into a harmonious whole fitted for fulfilling those important functions which in other countries are being better fulfilled by the stock market.

32. Further, if the present confused state of things in the stock market is allowed to continue, the savings of the country may continue to flow into hoarding and other unproductive channels as they have flowed for ages, and this may be a serious handicap to the long-term economic plans made lately for improving the lot of the miserably poor people of this country.

CHAPTER IX.

METHODS OF CONTROL IN OTHER COUNTRIES.

Imperfections in the security market of the kind mentioned in Chapter VI have not been confined to India. Any deep research is not necessary to show that in years gone by, there had been unbridled speculation in most of the advanced countries, and that serious consequences followed. But the Governments of those countries did not allow such a condition to remain for long. They had to intervene and by legislative enactments and administrative arrangements they have placed severe restrictions on the freedom of speculators and have thereby brought order out of chaos in their security markets. It is for us in India to study their experiences and adopt such laws and administrative arrangements suited to the conditions and requirements of this country.

2. Foreign stock markets may be classified under two groups according to the degree of State regulation exerted on them. In the first category come London and Amsterdam, where State regulation is least. In the second are Paris, Berlin, Tokio and New York with varying degrees of State control as will be shown below. Somewhere between the two is the position of South Africa, where a fairly comprehensive law was enacted early in the current year (1947).

I. London and Amsterdam.

3. It is true that in countries where stock market dealings began earliest, i.e., Amsterdam and London, the need for regulation was long found unnecessary. Although as early as 1734, not long after stock dealings began in England, an Act of Parliament was passed "to prevent the infamous practice of stock-jobbing," this trade was not stamped out. On the other hand, the stock brokers in London grew in numbers and influence and as early as 1801 they established the London Stock Exchange, a voluntary unincorporated association with no Charter nor any Act of Parliament shielding it.

4. Under the Deed of Settlement of 1802, as modified by a similar Deed of 1875, the administration of the London Stock Exchange is vested in two bodies, namely, nine Trustees and Managers (representing the Company) who maintain the Exchange building and equipment, and a Committee for General Purposes composed of 30 members who are in charge of the regulation of business, the enforcement of rules and the admission of securities. As shown in Chapter II, this system of dual control has lately been modified, but not drastically. Various efforts have been made to bring the London Stock Exchange under some sort of State regulation, but owing to the high traditions of honesty and efficiency established by this autonomous body, the wisdom of such interference was again and again doubted. A Royal Commission in 1877 made a searching enquiry into the constitution, customs and practices of the Stock Exchange and a few minor modifications were recommended. Some of these recommendations were voluntarily carried out by the Exchange, but no legislative enactment was found necessary for this purpose.

5. So long as the securities trade was confined to the Stock Exchange, strict discipline was maintained without any official interference. But with the expansion in recent years of speculative activity, a large number of independent dealers arose in London and

over them the London Stock Exchange had no power. The Board of Trade came to be concerned about the share-pushing activities of private dealers, and especially after the Hairy Crash of 1929, considerable attention was directed on the subject. An enquiry into this matter was conducted by the Board in 1937 and as a result the Prevention of Fraud (Investment) Act, 1939, was passed empowering the Board of Trade to make stringent rules for the prevention of fraud in the share-pushing activities of private dealers. Although the Board's authority under the Act covers only the over-the-counter section of the stock market (i.e., private firms and dealers), the power thus exercised is of an extensive and detailed character, as indicated by the rules (see Chapter XI) connected with fraud, non-fulfilment of contracts, as subjecting contracts to unknown or vague conditions, misuse of customers' fund and securities held under safe custody, or hypothecation, inequitable transactions with clients, unlimited use of credit, etc.

6. The Amsterdam Stock Exchange has also long preserved the tradition of autonomy, except that it has now one Government representative on its Board of Directors. Thus the two oldest stock exchanges in the world are both almost entirely self-governing. In London, however, although the main stock market is still an autonomous body free from Government control, attempts had to be made lately for regulating private dealers.

7. In the present circumstances of this country, we are not in a position to follow the example of the U. K. (nor of Holland) in this matter. In both those countries, stock exchanges are old-established institutions carrying on a great tradition and conducted by men of great financial acumen and integrity. The Royal Commission of 1877, after a searching enquiry, found that the Committee for General Purposes of the London Stock Exchange had "acted uprightly, honestly and with a desire to do justice." Such searching enquiries have not been conducted in India, but judging from the little that we know about them, most of the stock exchanges in India are in quite a different condition and their operation, as shown in Chapter VI, calls for serious public concern in many ways. National characteristics do vary from country to country. Merely by adopting the rules of a well-conducted stock exchange abroad, another country cannot have equally well-conducted exchanges. It all depends on how the rules are enforced, the kind of persons operating them, their training and experience, and the motives that impel them. It is not necessary to enlarge any more on this, as a great deal of data regarding it have been given in the last two chapters.

II. Paris, Berlin, Tokio & New York.

Paris.—8. The stock market in France is, as it were, concentrated in Paris. There are three branches of it, all occupying the same building: (i) the *Parquet*, or official market, occupies the interior of the Bourse (a building owned by the City of Paris and rented by the brokers); (ii) the *Coulisse*, or curb market, operates on the steps of the building; and (iii) the *Marche Hors-cote*, or free market, which too although unorganised is located in part of the colonnade of the official exchange building. (It should not be concluded that all these three are competing exchanges; they are not, as will be shown hereafter).

9. The *Parquet* is a monopoly operating under the close control of the French Government; it possesses a legal monopoly of the business of buying and selling for others the securities officially listed.

All the important practices and regulations of it have been enacted into law and they are administered under close Government supervision. The membership of the *Parquet* is limited by decree to seventy persons who form an official body of "stock brokers" (as they are called). They are appointed by the President of the Republic, but the members thus appointed have the right to introduce their successors when they retire. The *Parquet* is the only stock exchange in Europe in which membership has a transferable value similar to that of a seat of the New York Stock Exchange. But nominees must be Frenchmen and must have served an apprenticeship for a specified period. Even then the approval of the Ministry of Finance is required for appointment as member.

10. The governing body of the *Parquet* is a Syndical Chamber of eight members elected by the 'stock-brokers,' but this Chamber has to work under the supervision of the Ministry of Finance. The Syndical Chamber has wide powers. It may summon stock brokers, call for their records and order them to take measures of safeguard in case their financial position is weak. All these measures have become necessary because of the principle of collective responsibility of stock brokers—*solidarite* by which is meant a mutual guarantee of solvency whereby the liabilities of defaulting members are met from the general funds. (This practice, however, is voluntary and not prescribed by law). The extent of the supervision by the Ministry of Finance may be seen by the fact that minimum brokerages and commissions for the various types of transactions are fixed by the Ministry.

11. The *Coulisse*, or curb market, deals in securities which are not qualified for listing on the *Parquet*. However, securities listed on the *Parquet* can also be dealt in when the *coulisiers* ('bankers') obtain official statement or counter-signature from a 'stock-broker' for which the latter is entitled to get part of the brokerage. The *Coulisse* is administered by a syndicate constituted of bankers, which maintain rules and professional discipline among the operators of the market.

12. The *Marche Hors-cote*, or free market, is in a more unorganised state than the *Coulisse*. But, even here, some regulations have been introduced for the conduct of business since 1928. Transactions in this free market are permitted only in securities between the time of their issue and their collection on one of the other markets. Certain inactive securities of small companies are also permitted to be dealt in. Thus, all the three constituents of the Paris stock market have each its own separate field and are prohibited from dealing in the same securities as has been happening in India.

Berlin.—13. In Germany stock exchanges are subject to very detailed Government regulation. A German Federal Law regulates all stock exchanges and their rules and regulations. Stock exchanges could be established only with the permission of the State Government which must approve their regulations and is entitled to suspend them if found necessary. The Berlin Stock Exchange, which is much the largest of the German Stock Exchanges, is under the strict supervision of the State Commissioner (appointed by the Prussian Government) who is responsible for the enforcement of all laws and regulations pertaining to exchange. He is to work in co-operation with the Chamber of Industry and Commerce, a semi-governmental organisation. Stock exchanges in other States are also under supervision of the Commissioners appointed by the respective State Governments.

A Commissioner is to watch the transactions on the floor and is to attend the meetings of the various committees of the exchange.

14. The management of the Berlin Stock Exchange is in the hands of a Board of Directors consisting of 21 members of whom 17 are chosen by the members of the exchange and 4 appointed by the Controller, Chamber of Industry and Commerce. The Board of Directors is to carry on its functions subject to the detailed supervision of the State Commissioner and the Chamber of Industry and Commerce. A close affiliation between the banks and stock exchanges is a notable feature of the Berlin Stock Exchange. This is true more or less of the Continent as a whole; but, in Germany the affiliation amounts to complete domination of stock exchanges by the banks. Banking corporations form a large part of the membership of the Berlin Exchange and transact the greater part of the commission business in securities.

15. There are strict regulations regarding listing. On the Board of Admissions concerned with listing, one-half of the members must be persons not professionally dealing in securities on the exchange. There is also a system of official price-fixing each day, under the supervision of the State Commissioner. There is only one official quotation a day for each security in the cash market.

Tokyo.—16. Under the law of 1893 as revised in 1914, Government control of the stock market is even more complete in Japan. Government has power to sanction the establishment and suspension of exchanges, to license brokers and to approve all the regulations and the appointment of officers. Government may also take power to inspect the books of the exchanges and of the brokers. When exchanges are joint stock companies—and most of them are such—they must deposit a guarantee fund with the Government. Brokers, in turn, must deposit a substantial sum with the exchange as part of a guarantee fund.

17. There is also a unique system of price-fixing. Buyers and sellers may agree on certain prices, but when the superintendent of the exchange beats the wooden clappers at the rostrum, all the trades are concluded at the last price recorded. Trade is carried on only in listed securities.

U. S. A.

18. Before Federal legislation was carried out in the U. S. A., many of the States had laws designed to regulate one or more phases of security dealings, and although in this work they had the co-operation, in inter-State cases, of the Federal Post Office Department, there had been no overall regulation of the security market. The need for Federal legislation came to be felt early in the present century and became urgent in 1913 during the money trust (Pujo) investigation. The stock market crash of 1929 and the exposures following on it strengthened the hands of those advocating Federal legislation for the rectification of widespread abuses. In April, 1932, the Senate adopted a resolution to carry out an enquiry into the matter. The coming into power of an Administration favouring stock market reform led by the dynamic personality of President Roosevelt paved the way for energetic legislation, and enactment of the Securities Act (1933) and the Securities Exchange Act (1934) was the result.

19. The former Act was designed to prevent misrepresentation, deceit and other fraudulent practices in the sale of securities. It is a company law, rendered necessary by the inadequacy of, and conflict

between, the State laws operating on companies. Under the latter Act (Securities Exchange Act), a comprehensive system of regulation and control was instituted over the stock exchanges and other stock dealers by making registration of all stock exchanges and dealers compulsory, by fixing margin requirements, by imposing restrictions on borrowings by brokers and dealers, and by prohibiting manipulation and other abuses in securities trade. Such control was to be carried out over the whole field of stock exchange dealings. Not only stock exchanges but the curbs which functioned in most cities, and the numerous private dealers engaged in "over-the-counter" dealings were thus brought under strict control. It was found that the control of security dealings was not enough for the regulation of the security market. The directors and officers of corporations were found to make unfair use of 'inside' information for manipulating stock market prices and therefore steps were also taken to prevent not only directors and officers of corporations but the member stock-holders from carrying out manipulations with the help of inside information. Provision was also made for making available to the public, information regarding the condition of corporations whose securities are listed on the stock exchanges.

20. For the administration of these two basic Security Acts and other laws enacted since then for controlling the stock market, a powerful Federal body, called Securities and Exchange Commission has been established under the Federal Government. This Commission was given wide powers to suspend the registration of stock exchanges and to call for information of any kind from members of the exchanges. And such powers have been widely and strictly exercised, as the successive reports of the S. E. C. will show. The provisions regarding the control of the stock market credit—margins, etc.—are administered by the Board of Governors of the Federal Reserve System.

21. At first the Commission administered only the two Securities Acts mentioned above. (Securities Exchange Act was amended in 1936 and 1938. The 1938 amendment permitted the formation and registration of National Securities Associations which would supervise the standards of conduct of their members under Commission regulation.) Subsequently, the following four Acts were made and they too came to be administered by the Commission:—Public Utility-holding Company Act, 1935; Trust Indenture Act, 1939; Investment Company Act, 1940; and Investment Advisers Act, 1940. In addition, various functions under National Bankruptcy Act are also performed by the Commission.

22. When the Commission began work there was considerable opposition from the stock exchanges, but gradually the usefulness of the Commission became widely recognised and today the relationship between the Commission and the stock exchanges is quite harmonious. Important achievements can be claimed by the Commission in respect of the reorganisation of the administrative structures of the exchanges, adoption by the exchanges of suggested rules for the regulation of various phases of trading, control of the use of credit in security transactions, the systematic surveillance of the volume of trading and the movement of securities' prices to eliminate manipulative practices, the control of short-selling, the disclosure of transactions in a company's stock by its officers, directors and principal stock-holders, registration of brokers and dealers and the improvement in the standards of conduct in over-the-counter business.

23. The Commission consists of a Chairman and four members. They are appointed by the President, by and with the advice of the

18
Senate. Not more than three of the Commissioners are to be members of the same political party. The Commission is assisted by twelve staff officers and ten regional administrators. The total staff exceeds 1,000 persons. The whole of the U. S. A. is divided into ten zones, each with a regional administrator.

Lessons from Abroad.

24. We may now draw some conclusions on the experiences of foreign countries regarding stock market reform. An important lesson to be learnt from the foreign exchanges dealt with above is that the whole security market must be brought under Government control in some way. In France, although the Bourse has three sections and the degrees of control over the different sections varies, each operates over a demarcated field and does not compete with the other. In Germany and the U. S. A., the whole market has been systematically brought under control and is made to work harmoniously. In no country is control exerted over some sections of the market and others left entirely free to indulge in any business it likes.

25. Secondly, the nature of Government control exerted and its exact degree differs from country to country. In Paris the *Parquet* is established as a Government monopoly; in Berlin the organisation and operation of the stock market are subject to detailed Government regulation. In the United States, legislation has been carried out in great detail and an effective administrative organisation has been established for carrying out the objectives of legislation.

26. It is for India to see what kind of state regulation or control is required here. In France, as mentioned above, stock exchange is a Government monopoly with membership limited to 70 persons appointed by Government. Such control by public servants of a trading institution like stock exchange may be suited to the conditions of France, where the Government is closely identified with people. In India too, the *etatisme* of the type evolved in France is familiar, especially in the rural sphere, and a partial justification may be found for Government control owing to the selfish use of stock trading by certain classes. Yet one wonders if it would be possible to have in India, at least for some time to come, a government or governments which could effectively administer stock exchanges. The experience of price control in India during war time is not favourable to the adoption of a Government monopoly over the stock market. Therefore, it may be wiser to leave the management of stock exchanges to private bodies, but regulate them in the national interest. This may be done either as in Berlin or preferably on the lines of the U. S. A. It may be noted that this was what Japan also did and Japan did this long before the U. S. A. by tardy steps adopted it. Although in the U. S. A. systematic regulation by Government started only in 1934, in no other country perhaps has regulation been more systematic.

India and the U. S. A.

27. The security market in India today has much in common with the security market in the U. S. A. before the legislation of 1933 and 1934. In the U. S. A. then, as in India now, there were three sections of the stock market and the lack of co-ordination between these three (although much less than in India now) paved the way for unbridled speculation. While the stock exchanges worked under definite rules and regulation, most curbs and over-the-counter firms

did not provide similar safety in dealings, and consequently, abuses were common.

28. The curb market in New York, it is true, had moved into a respectable building in 1921 and had also accepted a constitution, thus becoming a regular stock exchange. But, before this, it greatly resembled the Katni market at Calcutta as it has worked in the last few years. Curiously enough, this similarity is not only in the nature of business, but also in the external appearance of the market. Much of the business there was merely in the nature of gambling, not unlike that of the curb markets in India. Manipulatory practices were common in both curb markets. Of common use were "wash sales," i.e., sales of securities by which no actual payment or delivery was contemplated, and "matched orders," using two or more brokers, one to buy and the other to sell the same stock at the same time. Both these practices were used for rigging up prices and swindling the public. The following is from a report of 1920 :—"On the curb, there are no restrictions whatever. Any security may be dealt in and any one can meet there and make prices...."

As for external appearance, the following description of the latter by the well-known English writer A. G. Gardiner, 1920, fits in rather well with the Katni Market at Calcutta :—"In the street a jostling mass of human beings, fantastically garbed, wearing many-coloured caps like jockeys or pantaloons, their heads thrown back, their arms extended high as if in prayer to some heathen deity, their fingers working with frantic symbols, their voices crying in agonized frenzy, and at a hundred windows in the great buildings on either side of the street little groups of men and women gesticulated back as wildly to the mob below. It is the outside market of Mammon."

29. While the New York Curb Market became respectable by accepting a constitution, the smaller curb markets in other cities continued more or less in the old condition until they were amalgamated with the nearby stock exchange (as at Los Angeles and San Francisco) or dissolved (as at Chicago) under the direction of the Securities and Exchange Commission.

30. As for the over-the-counter firms, it is true that, unlike those in India today, the firms in America had even in those days confined themselves to distributing stocks of comparatively small companies whose issues were not listed on any regular exchange. Yet they had attracted a large clientele especially interested in oil, mining, motor and other highly speculative stock. "Unrestricted by any of the disciplinary rules enforced by our regular exchanges and unhampered in many states by adequate supervisory legislation, the operations of many of these promoters reached scandalous proportions." (Huebner).

31. In America too, the stock exchanges themselves functioned at different levels in those days, as in India today. The New York Stock Exchange, then as now, has been on a high pedestal. Even this exchange had shortcomings and those had to be rectified after the Securities and Exchange Commission came into being. Yet in most respects the New York Stock Exchange was far ahead of the other exchanges even before 1934. The listing regulations of the New York Stock Exchange were the most comprehensive, whilst listing was not so strict, in some cases hardly observed, on the smaller stock exchanges. Some companies refused even to give essential information on securities when regional exchanges asked for them. Many of these exchanges permitted trading in securities listed on the New York Stock Exchange, and this led to arbitraging until New York prohibited arbitraging with domestic markets. Similar differences are seen in

India today between the two recognised exchanges of Bombay and Ahmedabad on the one hand and the imperfectly organised exchanges of the smaller centres on the other. The difference is perhaps wider, although in India no single exchange occupies such a dominant position as the New York Stock Exchange in America. There too, as in India, stock exchanges outside New York then carried on trade chiefly in local issues, but with the consolidation of industry into units of national importance, this distinction gradually disappeared. A similar development had been taking place in India also in the last few years, at any rate, within the organised stock market. But outside it, confusion still prevails to a degree not paralleled in America or any other civilized country in modern times.

32. In America then as in India now, the authorities of stock exchanges keenly contended that outside brokers were responsible for the gross abuses in stock dealings. The New York Stock Exchange repeatedly argued that whatever efforts made by it to control manipulations were largely nullified by the fact that outsiders were usually responsible for such unsavoury operations. The authorities of the Bombay and Calcutta stock exchanges have used the same arguments frequently. In both cases, the claim is greatly exaggerated.

33. The selfish use of inside information by the directors and agents of companies is an important cause of the serious abuses in the stock market in India, as shown in Chapter VI. In America too, before 1924, directors and officers of companies had been using inside information to carry on manipulations in share prices, sometimes with the aid of stock exchange members. Contemporary reports give scathing accounts of the dishonest practices then prevalent in America among those participating in company administration—pool participation, granting of options, trading of officers and directors of a corporation in the shares of their own corporation, use of subsidiary corporations and management and service contract as means of indirect profit, including bonus and management profit sharing schemes. So long as management is divorced from ownership, the temptation is always present to benefit at the expense of the less informed. In India too as shown in Chapter IV, analogous evils have been operating and have become serious in recent years.

34. A similarity is also noticeable between the two countries in regard to the connection between the stock market and banks. Both in the U.S.A. and in India, banks do not carry on stock exchange business for their clients and their connection to the stock market is that they provide short-term credit to stock brokers and make loans on securities as collateral. Even this can be a menace as has been shown in the case of the U. S. A. in 1933 when thousands of banks failed as a result of a crash in bond prices. But that is a different matter. The point here is that neither in India nor in America banks perform a function analogous to that of brokers as on the continent and to a lesser extent in the U. K. Perhaps this is due to the comparatively undeveloped condition of branch banking in both America and India. In America, therefore, broking houses from cities have spread out into the towns all round by opening out branch firms. In India city brokers' branches have not spread out in this way and local dealers and firms carry on over-the-counter business with local clients. It is likely that with the expansion of transport agencies and with the extension of wire systems, India will also move in the same direction as America.

35. The analogy between the two countries goes much further. The position of the Federal Government of the U. S. A. in 1934 in res-

pect of stock exchange regulation was very much like that of India at the present day (see Chapter X, para. 19-21). In the U. S. A., many of the States had from time to time passed laws designed to regulate one or more phases of security dealings and most of the states had thus attempted to reach the more obvious forms of security fraud. Then, as now, the great bulk of security dealings was in the New York Stock Exchange and the New York Curb Exchange, and it was there that a widespread agitation for Federal legislation started as early as 1913.

36. In India too, as had already been shown in Chapter I, stock exchange dealings had been for long confined to Bombay, Calcutta and Ahmedabad. Bombay for long was the storm-centre, and it was there that the first attempt at interference was made as shown before. The need for central action soon came to be felt as in the U. S. A., and the urge became powerful after the experiences of World War II.

122

CHAPTER X.

THE NATURE OF REGULATION.

Having examined how in other countries the stock market has been brought under regulation, we are now in a position to consider the methods by which suitable regulation may be carried out in India.

The Work before Government.

2. In the first place, as has been shown before, the entire security market in India should be brought under control. The futility of any regulation by leaving any section of it unregulated has already been shown.

3. Secondly, it is not enough to take power over one class of dealings only, as the Bombay Government did in 1926; power must extend over all classes of dealings and all stages thereof, so that safety in dealings and equity between parties may be secured, in the best interests of the public. Nor is it enough for Government to have power to approve rules, but must have also rule-making power. Exchanges neglecting to observe rules may have not only to be warned but even superseded, should necessity arise. Credit facilities for speculation will have to be regulated. Equally necessary is the power to curb manipulations and pool activities; especially in disturbed times, maximum and minimum prices of some securities may have to be fixed and enforced in order to check the anti-social activities of mischievous operators bent on making private gains at the cost of the public, especially in times of panic and political uncertainty (as in the last few months).

4. Thirdly, for carrying out a comprehensive regulation of the above kind, it is not sufficient to bring the security market alone under regulation. Regulation will be ineffective so long as the company directors, officers and agents can, by using inside information, manipulate stock prices and thereby make unfair profits so long as company promoters and their friends are allowed to defraud genuine investors by various ingenious staging methods. This could be partly done by stock market legislation, as in U. S. A., but a stiffening up of the company law is also necessary for effective results. The Company Law, in spite of the amendment of 1936, is still full of loopholes, and the control of Government over the working of companies is quite nominal. Returns of a sort are indeed periodically made to the Registrars of Companies in the Provincial Governments, but no competent authority scrutinises them, nor have any effective steps been taken to detect and stamp out the nefarious activities by company directors defrauding their shareholders and investors in their shares. The control of capital issues was started as a war-time measure against inflation but has not so far been attuned for helping in the planning of investment. Thus, only by an over-all control of the whole investment market—capital issues, company floatations, company management, share dealings—can the too numerous evils sketched in Chapters VI and VII be kept under control.

Need for Effective Administration.

5. In the past, many important laws enacted by Government have proved ineffective owing to lack of competent machinery to administer

laws and to carry out the objectives of legislation in the national interest. Often an over-worked Government department was entrusted with additional duties, and especially in the case of important administrative matters in which urgent decisions are needed, they have proved ineffective and dilatory. This is partly because the departments lacked expert knowledge and had no definite ideas before them. Hence the complaint often heard from commercial bodies including stock exchange authorities about "outside interference from such slow moving ponderous bodies as Government, which are additionally handicapped by the lack of expert knowledge of the stock exchange." Especially in the case of the stock market as Mr. J. E. Meeker, formerly Economist of the New York Stock Exchange points out: "There is the very important necessity for swift and expert decisions. The stock exchange more than any business organisation on earth demands instant action."

Example of the U. S. A.

6. In these circumstances, the only way of effectively carrying out regulation in this important field is to set up a high-powered expert body, equipped with all the knowledge and experience required for making quick decisions and enforcing them effectively. This is what has been done in the U. S. A. by the Securities Exchange Commission, an independent, quasi-judicial agency of the Federal Government, empowered to carry out nearly all the functions mentioned above, and from 1934 when it was established, it has carried out these functions with alacrity and vigour.

7. The Commission has been granted wide and far-reaching powers. Those extend not only to the exchanges, but also to the members of these exchanges, to the companies whose securities are listed thereon, to the officers of the listed companies, and not least to the customers who trade with brokers. The importance of the work of the Commission can be seen from its action regarding (i) manipulation, (ii) unfair use of inside information by company directors, (iii) over-the-counter markets and (iv) stock exchange reorganisation.

8. (i) **Manipulation** includes various questionable practices employed by pools and professional speculators and often winked at by exchanges. Sections 9, 10 and 11 of the Securities Exchange Act of 1934 prohibit manipulation and empower the Securities and Exchange Commission to regulate manipulative devices. Under Section 9, certain specifically described forms of manipulative activity are prohibited. These are transactions which create actual or apparent trading activity, or which raise or lower prices, if they are effected for inducing others to buy or sell. Practices like "wash sales" and "matched orders" effected for the purpose of creating a false or misleading appearance of active trading or a false or misleading appearance with respect to the market of a security are declared illegal. Persons selling or offering securities for sale are prohibited from disseminating false information to the effect that the prices of security will, or are likely to, rise or fall because of market operations conducted for the purpose of raising or depressing the prices of a security. Persons selling or purchasing securities are prohibited from making false or misleading statements of material facts with knowledge of their falsity, regarding securities for the purpose of inducing the purchase or sale of such securities. The Commission is empowered under Sections 10 and 15 to adopt...

124
define and prohibit the use of new forms of manipulation which the Commission might encounter from time to time.

9. Under the authority thus vested in them the Commission has adopted rules and regulations for freeing security markets from artificial influences, thus ensuring the maintenance of fair and honest markets and allowing prices to be established by supply and demand. This has necessitated a systematic surveillance by the Commission of all trading in securities. Methods of great subtlety and complexity had to be devised. A preliminary investigation is carried out by the "flying quiz" which is designed rather to discourage incipient manipulation. When facts justified a more extended enquiry a formal investigation was carried out. In the early years of the Commission a few large scale manipulations were detected and some of these resulted in jail and other penalties.

10. (ii) **Unfair use of Inside Information by Company Directors and Officers.**—Effective provision has been made by the Act of 1934 for dealing with various sharp practices resorted to by the directors and officers of companies and their friends. Under Section 16, directors and officers of companies (whose shares are registered for trade) and stock-holders who own more than 10% of any registered issue of stock have to file with the S. E. C. and with the Exchange a statement of each such security, together with such changes of ownership as have occurred during each month. Such persons are also prohibited from either selling short or selling against stock, permanently held, of the issuing corporation. Any profit realised by corporate insiders from certain short-term transactions is recoverable from them by the issuer, and under certain conditions by a security holder also.

11. Another line of advance has been in making promptly available to investors all information regarding the position of the companies. Under Section 12 (which forbids trading in a security unless it is registered with the S.E.C. or exempted from registration), the Commission insists on detailed returns being submitted to them, not only annual reports but current reports in the event of certain material changes occurring in the affairs of the company (e.g., declaration of dividends, etc.) to be promptly telegraphed to it. The Commission has also power, under Section 10 (a) (2) of the Act, to suspend or withdraw the registration of a security if the issuer fails to comply with the above provision. These provisions have been further strengthened up in war-time, by the adoption of new rules.

12. Under Section 14 (a), the Commission is also authorised to prescribe rules concerning the solicitation of proxies, etc. in connection with listed securities, and the Commission has made strict regulations under this in the public interest or for the protection of investors. These regulations, it may be noted, facilitate active participation by security-holders in the affairs of their companies. As a large number of securities are not listed and are traded exclusively in the over-the-counter markets, fresh legislation has been enacted for bringing the issues of such securities also under the above protective provisions.

(iii) **Over-the-Counter Markets.**—13. The reorganisation of the over-the-counter firms was a prime concern of the Commission. Under Section 19 of the Securities Exchange Act, 1934 the Commission has wide powers to regulate the independent firms and outside brokers that form the over-the-counter market. Under it the Commission is authorised to make rules for the regulation of all transactions by brokers and dealers, for registration with the Commission of brokers and dealers and for the registration of securities for which they make or create a market. As there were little or no reliable data regarding the working

of these markets, the Commission began by making detailed enquiries on the subject. Subsequently, the hands of the Commission were strengthened by the addition to the Act, of sub-Section (c) to Section 15 making more definite the rule-making powers of the Commission. It makes unlawful the use of manipulative deception and other fraudulent activities and grants to the Commission the authority to define such devices and contrivances. A further amendment extended the Commission's powers so as to enable it to prescribe means to prevent manipulative acts except if exempted securities were involved.

14. Utilising the powers thus conferred, the Commission formulated comprehensive rules to guide the private dealers and brokers. Inspections by the Commission disclosed various improper practices, such as, failure to keep adequate records, to make the required disclosures in confirming transactions, etc. Many instances of serious misuse of customers' securities have also been uncovered. For instance, there were unlawful hypothecation and other fraudulent transactions for bringing secret profits to brokers (misrepresenting to the customer the price paid for the purchase of securities or price received by selling securities).

15. In the U. K. equally stringent steps are being taken by the Board of Trade under the Prevention of Fraud (Investments) Act, 1939.

(iv) **Reorganisation of Stock Exchanges.**—16. Under Section 5 of the Securities Exchange Act, the Commission was empowered to register as National Security Exchanges, those exchanges that come up to the requirements laid down by the Commission and to exempt those exchanges whose registration was not necessary, owing to the limited volume of their dealings. After a searching enquiry, 21 out of the 28 exchanges which had applied for registration were declared national security exchanges. This involved several mergers and dissolutions. Since then further mergers took place and the total number of national security exchanges came down to 19. Twenty-two exchanges applied for exemption, and eight were exempted accordingly. Others withdrew their applications and dissolved.

17. An important line of reorganisation attempted by the Commission was in regard to the constitution of the governing boards. It was found after a careful enquiry that the governing boards were not so constituted as to assume effective and substantial degree of responsibility for the conduct of their business. The Commission, therefore, recommended to the Congress that the governing boards should be more truly representative of members and members' partners and that the public also must be represented on the governing committees and in executive offices. The stock exchanges must be recognised as public institutions.

18. The New York Stock Exchange was then as now much the largest of the American Exchanges, having as much as 95% of the total turnover of trade in the country. The reorganisation of this exchange was found a most difficult task. The suspension of the firm of Richard Whitney & Co. for insolvency occasioned a thorough investigation into the affairs of the New York Stock Exchange and this disclosed the pressing need for a thorough reorganisation of it. Accordingly in 1938, a radically revised constitution was adopted with a paid president who must be a non-member. The administrative structure was greatly simplified and the number of standing committees was reduced from 17 to 7. Provision was also made for direct representation of the public on the board of governors. Subsequently, similar reorganisations were carried out in the Chicago Stock Exchange, in the New York Curb Exchange and several others.

The Problem Facing India.

19. The problems facing the investment market in India to-day are nearly the same; the conditions are also analogous. There are a great deal of abuses to be rectified and the conflicting claims of competing bodies have to be reconciled. Only a high-powered body like the S. E. C. could rectify these evils effectively. Some of the competing stock exchanges will have to be merged; others will have to be allowed to dissolve themselves. The constitution and rules of most of the exchanges will have to be revised and proper rules, as far as possible uniform for the whole country, will have to be made regarding membership, contract, settlement, clearing, listing of securities and not least the powers of the governing body to intervene in the market, e.g., suspension of scrips, suspension of buying-in and selling-out rules, suspension of short-selling, closing of the market, etc. The rules and regulations should aim at protecting not only members but also the public. Equitable and uniform practice must be the supreme aim of the rules.

Inadequacy of Provincial Action.

20. Only in this way could the stock market be reorganised for discharging the heavy public responsibilities falling on it. This cannot be done merely by legislation. The most stringent statute may not carry out this purpose unless it is administered by a competent authority with power over the whole country. It is generally assumed that it would be sufficient for the Centre to legislate; administration could be managed by the Provincial Governments. But no Provincial Governments will be able to carry out effectively the objects of this legislation.

In the first place, uniformity in the rules of business of the stock markets in all centres in the country has become essential, because, much of the trade in stock exchanges all over the country is in inter-market counters. It is in their prices that the wildest fluctuations arise, and it is these that cause serious loss to the investing public and affect the credit structure of the country. Although the larger markets in India are many hundreds of miles apart from one another, any serious disturbance in one of them communicates itself to other exchanges also. To take a recent example: the debacle of share prices in Calcutta during the latter half of 1946 had its repercussions immediately on Bombay, although the technical position of the latter market was not unfavourable then. Similarly, the Bombay market has also in the past exerted active influence on Calcutta. This tendency is so frequently noticeable that it may now be considered a normal feature.

Secondly, it is this above feature of the stock market that makes provincial action altogether inadequate to curb price fluctuations and to counteract the manipulative activities of powerful financial groups which are often out to loot. If it is agreed that both the boom of July-August, 1946 and the slump subsequently should have been kept under control, it also follows that only a powerful Central authority, could effectively carry this out. Similarly, when powerful pools of speculators operate on an all-India scale to rig up or push down the price of some active scrip, the Provincial Government will be absolutely helpless in counteracting such forces. It is essential that this should be recognised.

Thirdly, the same is true of the mischievous activities of company promoters and the directors and other officers of companies. The

Provincial Governments receive reports from companies, but there is no competent machinery to scrutinise details, and even if there were in one Province or two, it would be ineffective if other Provinces did not have such machinery. Therefore, if the company law is to be effectively used for safeguarding the interests of the investing public, a Central authority is essential.

Fourthly, uniformity in law and regulations has become necessary even in the self-interest of stock exchanges themselves. In the absence of uniform control by a Central authority, it would be found practically impossible to carry out urgently required measures of reform. If, for instance, Bombay wants to introduce any reform in the method of business and if that affects vested interests, there may be a wholesale migration of business to some other centre. Examples of the inconveniences caused in India in this respect have been given in a memorandum placed before the Morison Committee by the Bombay Stock Exchange. In 1926 on the recommendation of the Government of Bombay, the Bombay Stock Exchange passed a resolution that business in two Government securities should be allowed for purposes of fortnightly settlements (and not monthly as previously). But this resolution remained inoperative, on account of the fear of competition from Calcutta where the brokers did business on the basis of monthly delivery. Another instance is regarding action against blank transfers. The Morison Committee, although decided on making blank transfer a bad delivery, was faced with opposition on the ground that it would drive business from Bombay to other centres. The Committee had therefore to admit the difficulty of the position and expressed their view that "uniformity all over India is a desirable end to have in mind."

Serious difficulties in this respect were experienced in the U. S. A. before the Act of 1934. In 1933 when the City of New York attempted to impose a very moderate sales tax upon stock exchange transfers and a licence tax upon brokers, the New York Exchange promptly informed the City that it would move to Newark, New Jersey and had actually begun to prepare an exchange building there, and a cordial invitation was extended to the exchange authorities by the Governor of New Jersey. The City of New York had no other alternative but to recede from the tax. Similar situations have arisen between State governments also. Especially in India with numerous autonomous States lying interspersed with Provincial areas it will be, it has been found, easy to move into the neighbouring territory whenever anything inconvenient is imposed on any institution. Numerous recent examples of this can be cited in respect of many matters.

Fifthly, divergence in prices between exchanges will also cause various evils like arbitrage. The slightest difference in prices between exchanges will be eagerly watched by speculators and utilized for arbitrage transactions. Such transactions have already been going on in India, not only between distant markets, but between near-by exchanges in the same town. This also strengthens the need for a Central authority to watch price-trends and other tendencies in the national interest.

21. It follows from the above that for the effective supervision of the stock market not only legislation but administration must be central. On the same token, the supervision cannot be effective unless it extends over the whole geographical area of the Union, including Indian States, if this is possible by agreement. Nor can Company Law be administered in any other way, if it is to be effective in investments and thus call for confidence.

128
a Central authority could put an effective check on the sharp practices of company promoters at the floatation stage and of directors and other officers at subsequent stages, and provide for reliable information regarding companies be made available to investors. Only in this way could investments be made safe and the shareholders be given some hold over company management.

Need for an Expert Agency. A National Investment Commission.

22. Even in the Central Government, no existing department has the experience or necessary equipment, for bringing order out of chaos in this complicated field, for reconciling the powerful competing agencies operating and for keeping under control the strong vested interests which have been created by the inaction of Government in the past. Only an independent and quasi-judicial authority with the fullest powers of supervision could discharge such a function, and in this we cannot but follow the example of the U. S. A. The remarkable work of the Commission (sketched above) could not have been done in any other way. In the U. K., some of that work is being done by the old established body, the Board of Trade; but as shown above its burden in respect of the stock market is chiefly regarding the over-the-counter firms. The position in regard to the Indian stock market is fundamentally different. Here the line of action required is more or less the same as found necessary in the U. S. A. I have given my most anxious consideration to this problem, and am convinced that a National Investment Commission should be established in India for the supervision of the stock market. It is also my considered view that the same Commission should be charged with the administration of the Company Law and the capital issues control, because only by the co-ordinated control of all the three fields could the investment market be properly supervised in the national interest. Perhaps a Commission of three members could carry out the work, with the help of a competent staff.

Balancing of Investment not the Urgent Problem.

23. In his Budget speech, in February 1946, the Finance Member (Sir Archibald Rowlands) stated that the establishment of a National Investment Board was under consideration, "for the planning of investment, both public and private, with a view to securing the fullest and most advantageous utilisation of the economic resources of the country." At that time a similar proposal was being actively considered by H. M. G. for the U. K., but owing to practical difficulties in obtaining the statistical data required for such delicate decisions, the idea of balanced investment has been shelved for the present even in the U. K., and all that they could so far do was to give statutory sanction to the war-time control of capital issues. If such is the case in the U. K., how could anything in the nature of advanced planning of investment be possible in a country like India with such sore lack of statistical data? Hence the slow progress even in the consideration of this subject.

24. The planning of public investment is indeed more important in India, and will have to be attended to. But in the field of private investment, the need for making investment safe by the careful regulation of the stock market and capital issues and the proper administration of the Company Law is much more urgent in the case of India,

where the various agencies of investment are working very unsatisfactorily, as already shown. What is therefore more urgent is to set right these more fundamental matters.

25. In fact, one may go further and state that in the present conditions of this country, to attempt anything like a balanced investment without making investment reasonably safe is like putting the cart before the horse. In the U.S.A., a series of measures were taken, especially after the Wall Street Crash, to make investment safe, by the two Security Acts (1933 and 1934) and by allied legislation concerning investment companies, bankruptcy, public utility holding companies, etc. All these were entrusted to a powerful body to administer and as a result frauds in that field are now rare and investment has almost become fool-proof. In the U. K. too, the Board of Trade, has been doing nearly the same regarding company administration and lately the stock market also. The recent report of the Cohen Committee shows that the few loopholes left for sharp practices will also soon be closed, so far as possible.

26. Clearly, our urgent task in the field of private investment is to do what the U. K. and the U. S. A. have long ago done—to make investment safe so that savings may be encouraged. This calls for a more high-powered body than a National Investment Board, an Investment Commission with semi-judicial power over the whole of corporate enterprise and at all the stages of it—capital issues, company promotion, underwriting, company administration, and not least the trade in company shares (and securities as a whole). This is the most essential preliminary to any attempt at planned economic development in this country.

Need for Basic Legislation as First Step.

27. If the plea put forward above regarding the propriety and the urgency of regulating stock market finds support, our immediate step must be to carry out basic legislation taking at least the first steps in reorganisation. What is urgently required is for Government to take complete power to regulate the stock market by means of registration of stock exchanges and licensing of independent brokers, and to create a National Investment Commission for carrying this out. The Commission will begin by drawing up detailed rules for the reorganisation of the stock market and then (after any approval necessary) carry them out. The Commission may also take over the administration of the new Act for the control of Capital Issues, and also the Indian Companies Act, which it is hoped will soon be amended after the present enquiry by the Commerce Department. In this way, not only can immediate steps be taken for the urgent work of reorganising the stock exchanges, but provision can also be made for the co-ordination of, and a simultaneous advance in, stock market control and the administration of Company Law and Capital Issues. Thus the whole investment market of the country can be consolidated and made to subserve the best interests of planned economic development.

Legislation : The Constitutional Position.

28. Central legislation therefore is the immediate step required. But the Government of India Act, 1935, does not mention stock exchanges in any of the three Legislative Lists attached to Schedule VII. It has been construed by some that stock exchanges could be

included under item 27 of the Provincial List, i.e., Trade and Commerce within the Province. This apparently is a clear case of omission, because on grounds mentioned above, if banking and insurance have been expressly marked Central, so should stock market dealings have been.

29. Under Section 103 of the Government of India Act, 1935, the Central Government could obtain the consent of the Provincial Governments to legislate on subjects mentioned in the Provincial List. Pursuing this line of approach, steps have already been taken by the Central Government (Finance Department) to obtain the consent of Provincial Governments for Central legislation, and nearly all the Provincial Governments have agreed to Central legislation, some reserving their right to confirm their consent after the issue of this report. It is hoped that the consent thus given will be availed of at the earliest possible opportunity, so that the urgently required reorganisation may commence early.

30. Assuming that basic legislation may thus be carried out, will this be adequate to authorize the Central Government to set up a Commission to administer the Act? It is for the Legislative Department to express an opinion on this.

31. It may however be pointed out that in the U. S. A. too, there is no mention of stock market dealings among the functions allotted to the Federation. As the States possess residuary powers, they had been legislating on stock exchanges, but since 1920, the need for Central action in this field became urgent. Especially after the Wall Street crash of 1929, public opinion strongly favoured Central regulation, and after Roosevelt became President, Federal legislation became a settled fact. But it must be noted that the power that the Federal Government now use to regulate exchanges rests on the Government's authority to control the uses of the mails and of various agencies of trade and transportation in inter-State commerce. The Securities Exchange Act of 1934 appeals to other governmental powers also for federal action (see Section 2, paragraphs 1 to 4). The Act asserts that the prices of securities are the basis for determining the amount of certain taxes owing to the United States, that manipulation of security prices produces unreasonable expansion and direction of the value of credit available for trade and transportation in inter-State commerce, and prevents a fair valuation of collateral for bank loans and obstructs the effective operation of the national banking system and the Federal Reserve System; also excessive securities speculation and manipulation produce national emergencies and national unemployment and dislocation of inter-State trade and commerce with the resulting burdens of expense to the national government.

32. On the strength of such powers, the Federal Government in the U. S. A. has carried out not only detailed legislation regarding the trade in securities, but has also set up a high-powered quasi-judicial body like the S. E. C. to administer it, as it was convinced that only such an authority could administer the law effectively.

33. Most of what is mentioned in the above paragraph applies to India as well. The stock market transactions vitally affect the banking and financial system as a whole in India also, and affect inter-provincial trade and commerce also seriously. The mails (Post Office) are in India too controlled by the Central Government. So is the Company Law. Whether this analogy of the U. S. A. holds in the case of the Government of India Act, 1935 is to be considered. If the consent received from the Provinces under Section 103 is adequate, not only for legislating, but for setting up a competent authority to

administer the law, the Central Government may take action immediately. If not, I recommend that, in view of the urgency of the matter, the Governor-General's powers (in his discretion) under Section 104 of the Government of India Act (1935) should be invoked. By a declaration under this Section by the Governor-General this subject can be placed in the concurrent list.

Basic Legislation : Main Lines.

34. In the legislation contemplated, the Central Government should take power—

- (i) to regulate the stock market by licensing stock exchanges and other dealers in stocks ; to make rules and bye-laws for them, and to supersede and directly administer the exchanges, if need arises,
- (ii) to register securities seeking to be enlisted on stock exchanges,
- (iii) to impose restrictions on budli, blank transfer and other objectionable practices,
- (iv) to administer the laws thus enacted directly or by establishing a Commission,
- (v) to fix margins for stock dealings from time to time,
- (vi) to call for brokers' books to audit, to examine the financial position and to call for explanation from brokers, if need arises ; and
- (vii) to levy a sales tax on the sales of securities, principally for raising the funds essential for meeting the cost of such regulation.

Rule-Making.

35. Of course, registration and licensing would necessitate certain uniform rules being drawn up for the regulation of business. This can be done by issuing rules and regulations. Subsequent legislation may also be necessary, but it would be best to carry out such legislation after detailed enquiry by the Commission. Decisions on important matters like the continuance of budli dealings, the fixing of compulsory margins and their administration, the curbing of blank transfers, etc. will thus have to wait till the Commission begins to function. The sharp practices of company directors can be partly tackled by the provision regarding registration of securities, but this will have to be followed up by suitable legislation and by promulgation of adequate rules.

36. For assisting the Commission or other authority set up, it may be advisable to have a standing Council of Stock Exchanges composed of representatives from stock exchanges in different parts of India.

An Appeal to Constitution-Makers.

37. Finally, it is necessary to stress the need for including stock market dealings in the Central or Federal list in the new constitution that will soon be drawn up for India (and for Pakistan). The first duty of any Government immediately after independence is attained must be to launch a plan for rapid economic development so that the standard of living of the masses of this country, now so low, may be raised to reasonable levels. As the capital needed for this purpose will have to be raised mostly by corporate enterprise, the establishment of a properly regulated investment market must be considered an essential preliminary step. It is hoped that this aspect of the matter

132

will not escape the attention of the constitution-makers, and that the defect in the 1935 Act in this regard will be rectified by giving the Federal Government full authority in regard to the regulation of the stock market. The reasons which persuaded the framers of the 1935 Act to include banking and insurance company law in the Federal List must now incline their successors to place stock market dealings also in the same category. Further, to give the Centre exclusive power over Company Law and Capital Issues and to allow provinces to regulate (or not to regulate) dealings in company shares will lead to serious incongruities which may prove deleterious when any plan for economic development is launched. On these grounds and on others already mentioned earlier in this chapter, it is hoped that in the new constitution stock market dealings will be included in the Federal List.

125

CHAPTER XI.

LINES OF REGULATION—PROPOSALS.

If it is decided to set up a National Investment Commission, as suggested in the previous chapter, it will be best to leave to that body the drawing up of rules and regulations regarding the conditions of registration of stock exchanges and outside dealers, and the conduct of business to be insisted on. These matters will have to be decided in consultation with the stock exchanges. It is therefore proposed to deal in this chapter with only a few salient points.

No Rigid Control Recommended.

2. The need for bringing stock exchanges and outside brokers under regulation has been stressed in the previous chapters. But the object of the regulation, let it be noted, will not be served by bringing the stock exchanges under a rigid control which may deprive them of the initiative necessary for conducting exchanges successfully. As it is not our purpose to make stock exchanges a quasi-Governmental organisation as in France and elsewhere, we must make every effort to impose responsibility on stock exchanges themselves for the proper discharge of their functions, the duty of Government being chiefly to see that proper regulations are accepted and strictly carried out. In order to enable stock exchanges to discharge the functions expected of them, we have to see that, they are properly organised with suitable rules of business; we have also to free them from the vexatious competition of curb traders and free-lance brokers, which has lately been one of the chief causes of confusion in the stock market.

Re-organisation A Pre-requisite.

3. Unfortunately this objective cannot be immediately carried out, because most of the existing stock exchanges are not properly organised. Some of them have not even got written rules and most of them are not infrequently slack in enforcing rules. Even some of the biggest of them have a habit of taking the line of least resistance, and owing to the pressure from interested parties malpractices are connived at. For one reason or other, the governing boards are often not able to curb the overweening speculative inclination of members. Therefore, it must be our aim, *firstly*, to reorganise the stock exchanges and revise their rules, in order to bring them up to reasonable standards and to strengthen their governing boards for enabling them to enforce their rules effectively, especially in times of emergency; *secondly*, to apply more or less the same rules in regard to the outside markets, and *thirdly*, to see that each section of the market is allotted a definite sphere of trade, so that unhealthy competition may not take place between the two.

4. For carrying out these objectives, the most essential thing to do is to give a monopoly in each city to one stock exchange for the trade in their listed securities. In those cities where any legitimate need is felt for a second stock exchange with a different list of securities they can also be given permission to trade, on the lines of curb exchanges in the U.S.A., provided they also work under approved rules and will not butt into the legitimate sphere of the principal stock

12A. Authorities of two stock exchanges in Ahmedabad sent me memoranda stating that more than one stock exchange should be permitted in their town; their representatives also met me to discuss this question. But I have not found it possible to modify my recommendation regarding this matter in any way.

Registration of all Exchanges and Outside Brokers and Dealers.

13. No stock exchange, curb market, outside brokers or dealers should be permitted without a licence. Trading in stocks and shares without such registration must be made illegal, as has been done in the U.S.A. by Sections 5 and 15 of the Securities Exchange Act, 1934. Enough has been said above to show that this restriction cannot be a legitimate grievance to any one. If banking calls for such regulation, stock market dealings are in greater need of it. We have seen how in the past unregulated stock dealings have led to over-trading and injurious fluctuations in stock prices. This cannot be prevented so long as people could trade in stocks and shares and even organise stock exchanges without their rules being examined by some supervising authority. A few years ago, the U. K. was the only country (besides Holland) where stock exchange transactions could be carried on without much regulation; even there stringent control has lately been established by the Board of Trade.

14. All stock exchanges, curb markets and independent brokers must take out licences authorising them to trade in stocks and shares. Licences must be given under prescribed rules which insist on certain standard practices being observed. Only with the previous consent of the Commission should stock exchanges suspend the buying-in rule or suspend short-selling or close the market for more than 24 hours. Proper contract forms should be prescribed and enforced. Fulfilment of contracts by payment and delivery should be enforced whether on organised exchanges or in the outside markets. The rules of licensing, however, may have to vary as between different sections of the stock market. A reasonable fee must also be charged at the original registration and every renewal of licence.

15. Members of a registered stock exchange need not take out separate licences from the Government. It is true that in France and Japan, members as well as the stock exchanges have to take out licences. But this is not necessary in the conditions of India.

Organisation of Stock Exchanges.

16. It is not possible in this report to give detailed rules regarding the reorganisation of the stock market. Rules and regulations, may be drawn up in detail in consultation with the stock exchanges. However, some important points will be dealt with here. If, as was recommended in Chapter VIII, a National Investment Commission will be set up to administer the law, its first duty will be to decide on the rules and regulations to be enforced.

Should Stock Exchanges be Incorporated?

17. As has been shown in Chapter II, some of the stock exchanges in India are voluntary associations while others—a larger number—are limited liability companies. It has been held by some that all stock exchanges should be organised as joint stock companies; thereby it is thought that the affairs of the stock exchange should be

under some control. This is based on a misunderstanding. A stock exchange is fundamentally different from other businesses. It does not engage in any trade itself but only gives facilities to its members to trade (in stocks and shares). As expressly stated in their objects, stock exchanges are organised "to furnish exchange rooms and other facilities for the convenient transaction of business by their members as brokers." It is therefore more like a private club. As in the case of other private clubs, it is necessary to regulate the activities of members among themselves by definite rules and regulations. Hence the other object enumerated: "to maintain a high standard of commercial honour and integrity among the members and to promote and inculcate just and equitable principles of trade and business." In other words, a stock exchange does not directly deal with the public, nor transact any business in its own name. Therefore, incorporation is not essential. The body that runs the stock exchange may be either incorporated or not; it may be a joint stock company, or it may be a voluntary association. Uniformity is not essential in this respect.

Rules and Regulations.

18. Uniformity, however, is essential in the methods of business on the stock exchanges and other constituents of the stock market (curb exchanges, independent firms, etc.). In other words, whatever may be the nature of their organisation, stock exchanges must work under a code of uniform, clearly defined and written rules and regulations approved by Government. Government must have also the ultimate power to add, to alter or rescind any of the rules. It may be best to provide the stock exchanges with a set of model rules. In the event of an exchange failing to observe any of the rules, Government should have the power to enforce such rules, even by superseding as in the case of municipalities. The rules should provide access to the public for remedies against their members, on an undertaking by the public that the verdict of the exchange will be accepted without demur. Equity should be provided to the transacting parties, whether between members and clients or between parties through members as agents. The relation between broker-members and their clients should also be defined in the regulations, so as to provide safety to investors for whose benefit the market is provided and even to general public who have a large stake in the concern. (See Chapter V, paras. 30 to 39 for the essential purposes to be worked out in the rules.)

Should Members Provide Security ?

18A. Certain fundamental rules must be insisted on in the Act itself as a condition to licences being granted to Stock Exchanges. One of them is regarding securities to be taken from members. Provision for members of stock exchanges giving sureties or security and contributing to a guarantee fund exist in the legislation of many countries. In the recent legislation in S. Africa (Stock Exchange Control Act, 1947), not only has an applicant for membership to satisfy that his assets exceed his liabilities to the extent of at least £5000; but he has also to provide sureties or security to the satisfaction of the committee of the stock exchange, in an amount not less than £2000 for the discharge (during the first three years of his membership) of his liabilities arising out of transactions entered in by him in respect of stocks and shares. In the case of those who are already

12 8
members, but not completed the period of three years, the amount of security will be proportionate to the length of the unexpired period. In addition, every member has also to contribute to a fund (approved by Government) established for the purpose of securing the discharge, after the excussion of the member concerned, of any liability of such member up to an amount of not less than £3000 arising out of any transaction entered into by him in respect of stocks and shares. Having regard to the sharp practices of stock brokers in India, referred to in paras 19 and 20 of Chapter VI, it may be advisable to make some such provisions in the rules to be drawn up for licensing stock exchanges.

Outside Representation on the Governing Board.

19. Should the governing board have on it representatives from outside the stock exchange? Opinions have often been expressed that it is advantageous to have on the governing board representatives of important commercial bodies and banks. On the London Stock Exchange, there is no such outside representation. In New York and Berlin, and even in Amsterdam, there is provision for outside representation. On the Board of Governors of the New York Stock Exchange sit two representatives of the public and a varying number of non-member businessmen. Similarly four members of the Berlin Chamber of Commerce (a semi-government organisation) are on the committee of the Berlin Stock Exchange. In Amsterdam, one representative of Government sits on the Board of Directors. It is, however, doubtful if such outside representation will be effective for counter-acting the self-interest of the inside members, as members from outside may not always be available to attend meetings, especially emergency meetings, the need for which may frequently arise in the course of the stock exchange business. The suspension of cornered scrips or timely action to prevent a corner or a hammering when it is in sight cannot wait till members from outside assemble for a quorum. The usefulness of outside representation will largely depend also on the nature of experience possessed by the outside representatives. If suitable persons can be found on the spot, outside representation may be useful. It may be advisable, for instance, to have on the governing boards of stock exchanges one representative of the shareholders' association, if any, and of the Provincial Government, Finance Department. This will at least serve as a restraining influence.

President.

20. Perhaps more necessary than outside representation on the governing board is that the President should be one who can have enough independence for enforcing rules against the pressure of powerful vested interests within the stock exchange. How this is to be managed is to be carefully considered. In any case, presidentship, at least in the larger stock exchanges must be a full-time appointment for a term of years and the holder should not function as member during his period of office. It is also for consideration whether the appointment and removal of the President should have the sanction of Government.

The New York Stock Exchange has a Chairman as well as President. The Chairman is elected by the members to hold office for one year, and must be a member of the Exchange. The President is elected by the Board of Governors "to serve at the pleasure of the

Board." If he happens to be a member of the exchange, he must dispose of his membership. The President is the chief executive officer of the exchange and represents the exchange in public matters. He appoints various committees.

Powers of the Governing Board.

21. One of the crucial issues connected with the working of stock exchanges is regarding the powers to be vested in the governing board to interfere in the normal operation of the market. A fundamental principle of stock exchange administration is that except in certain clearly definable circumstances there should be no interference with the natural course of the market. As the Morison Committee put it: "Every bargain must be regarded as a contract to deliver or to take delivery of a stated amount of stock at a stated price and within a stated time," and any failure to implement fully such contract on the terms of that contract, by bona fide money payment, must automatically and without exception be followed by a public declaration of default.

22. The special cases which called for interference by the Board of Directors of the Bombay Stock Exchange formed the subject of discussion by the two Committees that enquired into the working of the Bombay Stock Exchange. It is not necessary to go into earlier history. At the time of the enquiry by the Morison Committee, the governing board had the following powers of intervention in the normal operations of the market.

- (i) Power to suspend the selling out rule;
- (ii) Power to suspend dealings in shares and securities subjected to bear raids;
- (iii) Power to suspend the buying in rule;
- (iv) Power to suspend dealings in shares and securities in which a corner has been effected and fixed prices at which settlement in such cases may be effected;
- (v) Power to close the market in crises whether national or domestic in character.

23. In regard to (i), i.e., suspension of selling out rule, the Committee considered it undesirable to give this power to the Board, because in bear raids when prices reach a level below fair market value, a stage must inevitably arrive at which the natural forces of the market must operate and check the downward trend. In these circumstances, it was thought unsound in principle to intervene in order to protect unwary or reckless bulls, whether members or non-members.

24. The Committee, however, agreed that it was necessary to give the Board power to suspend buying-in of securities when circumstances appear to them to make such suspension desirable in the general interest. When the market is subject to bear raids, it cannot be said that the natural forces of the market cease to operate. But when an "effective corner" has been established, the natural forces do so cease to operate, and settlement of bargains can only be effected at prices which will not be dictated by individuals or group of individuals who may have successfully brought about a corner. The Committee, however, pointed out that on any stock exchange which realises its responsibilities, resort to suspension of the buying-in rule is only had in very exceptional circumstances. So far as Mr. Morison's recollection went, this power had been utilised in London only once in thirty years and that was to deal with a situation created by a temporary corner.

25. The Committee also thought that in the interests of the general public, in periods of emergency the Board should have power to suspend short-selling in any scrip or scrips with the least possible delay. But such power should be restricted to occasions when the general body of investors throughout the country have to be protected from the anti-social activities of unscrupulous individuals who might attempt to utilise a grave national or international situation to their own advantage.

26. It was the view of the Committee that in order to ensure against any improper use of the power of suspension of buying-in and short-selling, that power should be exercised only with the previous consent of Government. But the Board should have the power to close the market for twenty-four hours without the consent of the Government; but if closing is necessary for a longer period the consent of Government must be obtained.

27. The above recommendations were in the main accepted by the Governing Board of the Bombay Stock Exchange. On the whole, they have worked satisfactorily, and may well be adopted by other stock exchanges.

Forward Dealings and Budla.

28. It has been shown in Chapter V how facilities for forward dealings have been a potent cause of excessive speculation. It is not claimed that speculation would cease by the adoption of the cash basis. Nor is it our aim to stop all speculation; what we are interested in is to adopt a system which is comparatively less liable to be used for excessive speculation. The term settlement by the very nature—the long period allowed, facility for differencing and carry-over (budla)—lends itself to excessive speculation, and lures people to it, as explained in Chapter IV. The speculator may buy for the long account and sell short during the same period, with the hope of making a profit out of time bargains. The long period provided will lead to excessive speculation by members, and when prices move contrary to expectations, it may lead either to objectionable practices, such as settlement by payment of differences or may necessitate budla involving credit without appropriate security for its safety. The undesirable results of term settlements have been reaped in London also (see Chapter IV, para 7), in spite of the peculiar genius of the British to make the best of even bad systems. America, therefore, abandoned the term settlement system long ago, and Amsterdam after careful consideration decided not to adopt it.

29. The one advantage of forward ~~dealings~~^{market} is that it facilitates a large volume of trading, thus providing a continuous market in securities in which such trade is carried on. In the past, when the Indian stock exchanges were in an undeveloped state, this has been one of the motives for forward dealings being adopted. But with the large growth in the normal volume of dealings such special aid is no longer essential. This is demonstrated by the abundance of speculation in the exclusively cash market of the Calcutta Stock Exchange. On the Bombay Stock Exchange too, where forward dealings were banned in war-time, there was no appreciable fall in the volume of trade. And in view of the large increase in the number of securities in recent years, and the possibility of greater increase under a rapidly expanding economy, there does not seem to be any need for anxiety on this score.

30. It is true that the two Bombay Committees did not recommend the abolition of forward dealings. The Atlay Committee considered the abolition of the forward market a drastic remedy, not to be recommended, save in the last resort. The Morison Committee assumed that it has to continue under some restrictions. The fact is, both Sir William Atlay and Mr. Morison, having been brought up in the traditions of the London Stock Exchange, could not think of anything different, even in India. They indeed recognised its evils, but apparently took it as a necessary evil to be put up with, owing chiefly to the undeveloped character of the Indian stock market. This can no longer be considered a valid ground for continuing a system, which lends itself to undue speculation in a country where the temptation to gamble is very strong among a large group of persons. Further, New York has shown how under proper regulation the best results can be obtained from an exclusively cash market.

31. In these circumstances, it would be in the best interests of India in future to establish an exclusively cash market as was done at New York and elsewhere. This may be a drastic change if introduced abruptly; it may also lead to other reactions. In the meantime, therefore, forward dealings may be limited to a few special scrips appropriately selected for the purpose. Even these should be allowed only under strict controls, and under the special supervision of the Commission. Under no circumstances should scrips of credit institutions like banks be permitted for forward trading. In periods of panic and uncertainty—not only war, but political and communal troubles like those that occurred after September, 1946 (which let us hope will not recur)—the forward market must be suspended after due consideration by the Commission or other authority appointed to administer the law.

Ready Delivery Contracts.

32. Whether the above recommendation regarding forward dealings is to be carried out or not, the great bulk of dealings ~~will in any case~~ be on a cash basis. Therefore, various questions connected with it call for early decision.

33. One of them is the period of the contract. As mentioned in Chapter IV, this definition of the ready delivery contract as given in the Bombay Securities Contracts Control Act is vague, although in the old rules of the Bombay Stock Exchange the definition is more precise. (See Chapter IV.) Even more vague is the definition of cash dealings on the Calcutta Stock Exchange. Under the rules of that exchange, delivery and payment should be made *on or after* the second day from the date of contract. How long after is not laid down anywhere, and in practice deliveries are sometimes delayed for months. It has besides been noticed that the ready delivery period of the different exchanges in India vary between 3 days to 21 days. It is therefore essential that uniform rules regarding the performance of ready delivery contracts should be made and enforced, not only on all stock exchanges but also in all sections of the stock market.

34. The D.I.R. 94C defined a ready delivery contract as a "contract which must be performed by actual delivery of, or payment for, the securities specified therein, on a date not later than the 7th day (or if the seventh day happens to be a holiday next following) from the date of the contract." Subsequently, owing to some special difficulties complained of by the Bombay Stock Exchange, Government agreed to extend the period to two weeks. This permission was ostensibly intended to tide over a difficult situation, but some stock

152
exchanges have utilised this opportunity to relax their normal regulations in this regard. Whilst an extension of the period might be justifiable in very exceptional circumstances, the normal period must be much shorter. In this respect, the rules and regulations of the Bombay Stock Exchange prior to the introduction of the D.I.R. 94C were reasonable ("not earlier than the 6th day and not later than the eighth.") If this rule has been changed owing to the relaxation of the D.I.R., it may be pointed out that both the original D.I.R. and the relaxed rule expired at the end of September, 1946. Here is an urgent case for immediate intervention by any authority that may be set up for stock market regulation. The wide divergence in rules between the various exchanges is also a matter for urgent rectification by the promulgation of uniform rules.

Listing Regulations.

35. The necessity for tightening up the listing regulation of our stock exchanges has already been urged. Official quotation on a stock exchange does not guarantee the value of any security; but at least it ensures to the public full knowledge regarding the affairs of the company. Leading stock exchanges like those of London and New York have exerted powerful influence on company promoters and directors by insisting on certain minimum standards being maintained by them in the interest of the investor. In India, something like this has been done by the Bombay Stock Exchange. But most of the stock exchanges have not taken a firm line in this matter and therefore some doubtful companies have obtained official quotation on some of them. It is therefore necessary to insist on uniform listing regulations being maintained in all stock exchanges, leaving unseasoned securities to prove their mettle on curb exchanges, if any, or in the over-the-counter markets.

It was with a view to helping the stock exchanges in this respect that under the Securities Exchange Act of the U.S.A., all securities listed or seeking to be listed on the national security exchanges have to be registered in the office of the S.E.C. Not only has complete information regarding the working of the company to be filed initially, but returns have to be made from time to time regarding all material changes in company affairs. A similar step is essential in India and provision should be made for this in the forthcoming legislation.

Compulsory Margins.

36. It has been shown in Chapter IV that margin trading is practised in India. The larger firms insist on margins being deposited by their customers, but such insistence is not widespread owing to the keen competition among the eager brokers. It has been held that the introduction of compulsory margins would be desirable as a means of preventing the excessive use of credit and of controlling speculation and over-trading. It is believed that a great deal of business is being done in our stock market by financially weak persons. If all goes well, they can make money, and some have made much money this way. But all may not go well always. Past experience tells us so. In any case, it is necessary to check the excessive use of credit, and compulsory margins are one of the means used for this purpose in other countries, notably the U.S.A.

37. On the New York Stock Exchange, margin regulations have been in existence for a long time. Under the Securities Exchange Act

of 1934, compulsory margins have been introduced. Under Section 7 of the Act, the Federal Reserve Board is directed to prescribe from time to time rules and regulations in respect of the amount of credit that may be initially extended and subsequently maintained on in security. For the initial extension of credit, a standard was fixed, i.e., the credit to be extended on a security was an amount not greater than, whichever is the higher of, (i) 55 per cent. of the current market price of the security, or (ii) 100 per cent. of the lowest market price of the security during the preceding 36 calendar months but not more than 75 per cent. of the current market price. Under this Section the Board adopted regulation T, governing extension of credit by the members of the National Securities Exchange and brokers or dealers transacting business in security through such members; and regulation U which governs loans by banks for the purpose of purchasing or carrying stocks registered on National Securities Exchange.

38. While it may be true that compulsory margins have helped in reducing unhealthy speculation on American stock exchanges, they have not been effective in eliminating speculation. Between February, 1945 and January, 1946, the margin requirements in the U.S.A. were raised from 40% to 100%. Yet speculation went on all the same.

39. Although the margin is primarily the responsibility of the Federal Reserve Board in the U.S.A., the Securities and Exchange Commission has co-operated closely with the Board in the formulation of these regulations and has been conducting routine inspections of the books and records of brokers and dealers for this purpose.

40. In India, the question of margins has been under consideration in Bombay. Mr. A. D. Shroff, in his evidence before the Morison Committee, urged Government to take power to permit forward trading only under prescribed margin requirements. It was not enough to fix an initial margin; there was also need to maintain the margin at the required level as the transactions increase. He went further, and urged the need for every broker submitting daily a list of transactions at the overnight closing time, in order that the stock exchange authorities may see that the required margin is maintained.

41. The Committee was convinced that margins are necessary, but many of the proposed schemes were found too complicated for a market unused to such a system. The Committee suggested (i) a percentage margin on the initial bargain price, (ii) an additional percentage margin on the make-up price at the first settlement if the contract is carried over, and (iii) for the additional percentages as supplementary margins at each of the following settlements.

42. The margin on the initial bargain price may be fixed at 40 per cent. and the maintenance margin at 35 per cent of the current market price. Margin may be either in cash or in approved securities.

43. Should margins be provided by non-members only or by members also? Having regard to the large volume of transactions by members, it may be advisable to insist on members for providing margins? It is true that members of some stock exchanges have to keep a compulsory deposit with the exchanges. But such deposits are at present not very large (Rs. 20,000 in Bombay, Rs. 5,000 in Madras). Further such a practice does not obtain in many stock exchanges. If the deposit is made compulsory for members and if the amount fixed up is sufficiently large, members' margins may perhaps be reduced if not altogether dispensed with.

44. It is not enough to prescribe margins for those who deal on the stock exchange. Safety demands that strict margins should be prescribed in respect of banks' advances on stocks and shares. As

this is primarily a concern of the Reserve Bank, it would be for that authority to lay down rules in regard to such margins.

Brokers and Jobbers.

45. A vexed question, mooted for long, is whether the functions of broker and jobber should be separated. In India both functions are performed by the same persons. In fact, some brokers are not only jobbers, but also underwriters. It is true that on the London Stock Exchange there is a clear distinction between broker and jobber. In Paris too brokers are not permitted to function as jobbers. In New York, although there is a clear-cut division between brokers and jobbers, there are detailed restrictions which work out the same results in practice.

46. It would be a great convenience if jobbers and brokers can be separated. But there are great difficulties for such separation in India. There must be a much larger number of listed securities; the number of members must also be larger and there must be a sufficient number of members with large resources who are able to take up the exclusive function of jobbing. None of these conditions at present seem to obtain in India. It is on the larger stock exchanges in India—those of Bombay and Calcutta—that any attempt could be made in this direction, but attempts so far made have proved futile. It may be remembered that even in the U. K., on the stock exchanges in the smaller cities it has not been found possible to carry out the separation. The position of Indian stock exchanges is more analogous to that of the provincial stock exchanges than the London Stock Exchange. If separation is insisted on some of the exchanges may have to close down. A clear-cut division of members into brokers and jobbers is not possible.

Control of Jobbing by Brokers.

47. What is more required in the conditions of India is to strictly regulate the broking and dealing activities of the members, in the interest of the public. As things are now, there is necessarily a conflict of interests between a member's broking business and his own jobbing. In other words, it is extremely difficult for a member to trade for himself without prejudice to the best interests of his customers. This point has been urged by several prominent persons who supplied information in the course of this enquiry. One remedy proposed is to prohibit members from trading with their clients as principals. They should not be permitted to purchase from clients' securities or sell their own holdings to their clients. In the contract, the member should state from whom he has purchased or to whom he has sold securities. Brokerage should be separately stated in the contract, whether the contract be for the cash market or the forward market. Besides, members doing 'tharawani' work as in Bombay and Ahmedabad, and the 'shunters' of Calcutta, should be brought under strict control by adequate measures, as their activities are positively undesirable. One of these, as suggested by the Morison Committee, is the fixation of a large unit of trading as jobbers.

47A. In connection with the proposals in the above para, Section 14 of the S. Africa Stock Exchange Control Act is worth noting. "Any stock broker who has been instructed by any person to buy any stocks or shares on his behalf shall not, in connection with the purchase of those stocks or shares, enter into any arrangement whereby a lien of

buying those stocks or shares from any other person, he sells his own stocks or shares to such first mentioned person, unless he has obtained his consent thereto and disclosed to him in a note of purchase and sale that the stocks or shares are his own." Similar provision has also been made in regard to sales of securities through brokers. Having regard to the serious misgivings in the public mind regarding sharp prices by brokers, it may be advisable to make a somewhat similar provision in our legislation.

Minimum Brokerage.

48. As the custom of cutting rates of brokerage has in the past caused various evils, a schedule of minimum brokerage should also be fixed and enforced by the exchange, so that variations in stock prices between broker and broker may be avoided.

Need for Special Training for Membership.

49. It has been shown in the course of this report that the lack of training for membership has been a serious hindrance to the maintenance of proper standards by member-firms and their functioning as investment advisers to the public. One way of remedying this will be to insist on a minimum educational qualification and five years of apprenticeship in a member-firm as essential qualifications for membership. Provision must also be made for a special course of training being given to those intending to take up a stock market career. Wherever possible, such training may be under the auspices of the local University, and may lead to a University diploma on the subject. In the larger Indian cities, there are professional men competent for imparting such training, and it is for the Universities to take the initiative in organising such training under their auspices and thus enabling talented young men to prepare for lucrative careers.

50. A few memberships of the London Stock Exchange are reserved for authorised clerks who come up to certain standards of proficiency, and opportunities are also given to them for obtaining training. It is essential that such opportunities should be given to authorised clerks on the Indian stock exchanges also, and it will be desirable to make provision for the really competent among them being elected to membership. It may also be advisable to select every year a certain number of the clerks for the training mentioned above, so that by the time they become eligible for membership, they may become well equipped for discharging their responsibilities properly.

Holidays.

51. Apart from the habit of keeping stock exchanges closed when it suits the convenience of the governing board, there is an inclination to have too many holidays on stock exchanges in India. The Morison Committee found that the number of holidays in Bombay was excessive and that this "acted in a way detrimental to the reputation of the stock exchange." It must also be remarked that the religious objection urged is often a cloak to hide the real intentions. Rules may be so modified that the market will only be closed for purpose of holidays, on all Sundays, all bank holidays declared by the Government under Negotiable Instruments Act (which are themselves too many) and special religious holidays considered.

Clearing Houses.

52. A recommendation made by several persons is that clearing houses should be attached to all stock exchanges. There is no doubt that clearing will make settlements easier and make for orderly work on the stock exchanges. At any rate, in the case of active scrips, clearing is essential if the confusion, delay and malpractices are to be avoided. One serious obstacle to the establishment of clearing house is its heavy cost. Nor can Government be expected to incur expenditure for this purpose. If, in our two largest cities, the bulk of the business comes into one stock exchange, the maintenance of a clearing house should become economical. In centres where clearing houses are not available, settlement may be done in the stock exchange halls during fixed hours under the supervision of its authorities.

53. Even in London, the Settlement Department of the London Stock Exchange clears only the members' securities balances, and only in those securities which it proposes to handle for the current settlement. Transactions in securities not included in the current clearing list must be settled directly between the members concerned. If such is the case in the world's greatest securities market, one cannot see how stock exchanges in India could do very much in this line at this stage.

Blank Transfer.

54. The causes for the popularity of blank transfers have been dealt with in Chapter IV. This question has given rise to an acrimonious controversy. Both the Atlay and the Morison Committees have inveighed against the evils of the blank transfer, and the latter Committee recommended its total abolition, while the former was for stringently limiting its currency. The difficulties of abolishing blank transfer are great in a country like India with its vast distances, dilatory processes of registration and meagre staffs in companies' offices. In countries where every company has an office at the headquarters where the predominant stock exchange is located, transfers can be easily effected. This is the case in the U. K. But in India, head offices of many companies are located in distant cities and towns, and communication between them take a long time and involves much cost. In these circumstances, if the blank transfer is made bad delivery, as suggested by the Morison Committee, it would greatly impede the work of stock exchanges and undermine liquidity, which is essential for investment and capital formation. After all, blank transfer has not been abolished in any country; it has been held valid delivery even by the Privy Council. We should devise some method by which the facilities for over-speculation and tax-evasion can be greatly reduced, without undermining the liquidity of securities.

55. Various steps can be taken for this purpose. The first step must be to see that dividends of companies are distributed to registered shareholders only. The position is quite different now. Secondly, we must limit the currency of the blank transfer, say to two months, and for this purpose Government must insist on the use of transfer forms embossed with stamp fee and date of issue. The buyer then will have to take steps to register the transfer with the company within two months. Uniform rules must be adopted by all stock exchanges in this matter, and they will have to be strictly enforced.

56. One of the factors that have encouraged blank transfers in the past is the high stamp duty charged by the Government, and the

large transfer fees by some companies. It is for Government to see if both these charges are reduced. Thereby it may also be possible to reduce evasion and to raise larger revenues from these items.

Over-the-Counter Market

57. So far, we have dealt with the organised stock exchanges. Much as we may desire that trade in stocks and shares should be concentrated in organised stock exchanges, there may still be private firms and dealers. They have special facilities in dealing with certain classes of scrips, especially new issues, and such issues which for some technical reason or other may not be accepted for trade on the stock exchanges. Especially in towns not served by stock exchanges, dealers are bound to spring up to meet the needs of local people. All these have to be compulsorily licensed as otherwise, business is bound to flow from regulated to unregulated areas. The regulation of these private markets is essential, seeing that serious abuses are rampant and frauds widely practised in this section of the stock market.

58. In tackling such abuses and frauds, we may draw on the experience of both the U. S. A. and U. K. The wide powers exercised by the S. E. C. on the over-the-counter market have already been dealt with (Chapter IX). In the U. K., under the Prevention of Frauds (Investments) Act, power to control the over-the-counter markets is vested in the Board of Trade. Stringent rules have been drawn up by the Board for the licensing of private dealers. We in India may with advantage draw on these rules. The following are the conditions of licensing in the U. K. :—

- (i) The giving of true information as prescribed and substantiated by a statutory declaration ;
- (ii) The provision of reference as prescribed ;
- (iii) The provision of sureties as prescribed ;
- (iv) Undertaking to comply with prescribed conditions as to the conduct of rules ; and
- (v) That the applicant is not an undischarged bankrupt or has not been convicted of any offence involving fraud or dishonesty.

59. If, as in the U. S. A., when any association of private dealers is to be formed, it should be registered and licensed as a stock exchange.

Reform of Company Law.

60. Much has been said in this report regarding the unfair use of the stock market by the directors and other officers of companies and the sharp practices by the promoters and underwriters of new issues. The evils resulting from blank transfer have also been dealt with. Some of these evils can be rectified by the tightening up the listing regulations of the stock exchanges and by the compulsory registration of securities to be listed. But, as many companies may not seek listing, a reform of the Company Law is essential for effectively tackling the evils. Of course, as pointed out in Chapter X, only an effective administration of the law can produce the desired results. As the question of Company Law reform is under consideration in the Commerce Department, it is not proposed to deal with this matter here in detail. A few suggestions from the point of view of stock market reform may perhaps be useful.

61. With a view to discouraging the malpractices, regarding

Supply of Statistics.

63. If the stock market is to serve as a barometer of business condition, the data regarding its working must be carefully and diligently collected and studied. The importance of this has been fully realized in all advanced countries, especially the U. S. A. where not only are statistics on various operations of the stock market gathered but are also being interpreted by competent experts for the guidance of investors. The Dow-Jones averages, the New York Times Averages—these are well-known and very much used by investors in America.

64. The range of statistics collected by the various stock exchanges in the U.S.A. can be seen from the Monthly Statistics published by the New York Stock Exchange. The statement on next page is from a recent number of "The Exchange", a monthly publication by the Editorial Office of the New York Stock Exchange. It is for us to decide what exactly are the minimum statistical needs and how they can be met.

65. It is the duty of the Government to collect and publish statistical information at regular intervals, but this is only possible if the proper data are promptly supplied by the stock exchanges. So far, stock exchanges have been very reluctant in supplying data regarding their trade. "Stock exchanges have been traditionally resentful of all demands for information from outsiders, and fearful that such information would lead to governmental control. As a result they have kept the blinds closed as tightly as possible, against the searchlight of publicity." This was written in the U.S.A. several years ago and this is far from true there now. But, as for India, it must be stated that this fairly correctly represents the position today.

66. It is essential that Government should have power to collect statistics from stock exchanges and dealers. One of the conditions of licensing must be the sending of certain periodical returns to Government, and provision must also be made for the supply of any additional statistics that may be called for.

67. It should be a condition of registration of stock exchanges that they should supply statistics regarding their volume of business weekly to Government. For this purpose every member must file with his stock exchange an account of his daily purchase and sale within an hour of the closing of market. It should not be difficult for members to conform to this rule nor for stock exchange authorities to collate such figures into a weekly statement. Members who give wrong information or neglect this duty must be severely penalised by stock exchange authorities. If stock exchanges are essential for the functioning of our economic system it is equally essential that Government should be able to observe accurately the trends of business from time to time, and, in these circumstances, any negligence on their part must be considered as highly detrimental to social interest.

A Sales Tax on Security Transactions.

68. For undertaking a proper regulation of the stock market on any lines, funds will be required. It is but fair that such funds should be raised from the securities trade and not from the pocket of the general tax-payer. No doubt a part of these will come from the licence fees levied from stock exchanges and outside dealers, but this cannot be adequate. Further, so widespread and important a business as stock market has a duty to contribute to the general revenues, apart from whatever contribution it may be making to the income-tax and the

share dealings, of promoters and directors of companies, provision should be made for the following in the amended Act :—

- (i) In the case of new floatations, information regarding distribution of holdings at the time of allotment should be reported to the National Investment Commission or other authority established for stock market regulation.
- (ii) Immediately after the issue and original sale of shares a separate statement containing detailed information regarding allotment to directors, their relations and friends, and underwriters, if any, for the purpose of holding beyond the period agreed to for underwriting should also be sent to the above authority. For such reporting a definite period should be stipulated in the Act.
- (iii) Any change within a period of six months in the holdings of shares of a company by any of its directors or officers or even its auditors, directly or indirectly, should be forthwith reported to the said authority by the secretary of the company.
- (iv) Staggering by the directors or other officers of the company, directly or indirectly in the names of others, whether relations or otherwise, should be prohibited and even penalised by the forfeiture of such office.
- (v) Any purchase or sale of securities of a company by any of its own directors or officers or even its auditors, directly or indirectly, at any time within six months prior to the declaration of dividend, whether the security is registered or held in blank, should be reported to the said authority by the company as well as by the person concerned with the transaction.
- (vi) Declaration of dividends should be communicated to the said authority and the various stock exchanges, telegraphically or otherwise in minimum time, so that it may be published simultaneously in the different trade centres.
- (vii) Companies should be statutorily required to submit quarterly balance sheets.

62. With a view to discouraging blank transfer and allied evils, the following measures are desirable :—

- (i) Transfer fees chargeable by companies should be statutorily fixed and should be on the same *ad valorem* basis, i.e., it should not vary among the companies.
- (ii) A period for completing the process of transfer and registration of shares by the company should be statutorily fixed. Deviations or evasions should be penalised by a right to claim damages or loss. The period for transfer should be so fixed as to make the limitations of life of blank transfer practicable.
- (iii) Similarly a period for splitting or sub-division of scrips should be defined and fixed.
- (iv) Companies should issue certificates in marketable lots as practised on recognised stock exchanges.
- (v) Scrips in respect of new issues of companies should be issued within a specified time after the date of subscription of capital. (Long delays have happened in some cases on the ground that printing was delayed.)

Supply of Statistics.

63. If the stock market is to serve as a barometer of business condition, the data regarding its working must be carefully and diligently collected and studied. The importance of this has been fully realized in all advanced countries, especially the U. S. A. where not only are statistics on various operations of the stock market gathered but are also being interpreted by competent experts for the guidance of investors. The Dow-Jones averages, the New York Times Averages—these are well-known and very much used by investors in America.

64. The range of statistics collected by the various stock exchanges in the U.S.A. can be seen from the Monthly Statistics published by the New York Stock Exchange. The statement on next page is from a recent number of "The Exchange", a monthly publication by the Editorial Office of the New York Stock Exchange. It is for us to decide what exactly are the minimum statistical needs and how they can be met.

65. It is the duty of the Government to collect and publish statistical information at regular intervals, but this is only possible if the proper data are promptly supplied by the stock exchanges. So far, stock exchanges have been very reluctant in supplying data regarding their trade. "Stock exchanges have been traditionally resentful of all demands for information from outsiders, and fearful that such information would lead to governmental control. As a result they have kept the blinds closed as tightly as possible, against the searchlight of publicity." This was written in the U.S.A. several years ago and this is far from true there now. But, as for India, it must be stated that this fairly correctly represents the position today.

66. It is essential that Government should have power to collect statistics from stock exchanges and dealers. One of the conditions of licensing must be the sending of certain periodical returns to Government, and provision must also be made for the supply of any additional statistics that may be called for.

67. It should be a condition of registration of stock exchanges that they should supply statistics regarding their volume of business weekly to Government. For this purpose every member must file with his stock exchange an account of his daily purchase and sale within an hour of the closing of market. It should not be difficult for members to conform to this rule nor for stock exchange authorities to collate such figures into a weekly statement. Members who give wrong information or neglect this duty must be severely penalised by stock exchange authorities. If stock exchanges are essential for the functioning of our economic system it is equally essential that Government should be able to observe accurately the trends of business from time to time, and, in these circumstances, any negligence on their part must be considered as highly detrimental to social interest.

A Sales Tax on Security Transactions.

68. For undertaking a proper regulation of the stock market on any lines, funds will be required. It is but fair that such funds should be raised from the securities trade and not from the pocket of the general tax-payer. No doubt a part of these will come from the licence fees levied from stock exchanges and outside dealers, but this cannot be adequate. Further, so widespread and important a business as stock market has a duty to contribute to the general revenues, apart from whatever contribution it may be making to the income-tax and the

MONTHLY STATISTICS. NEW YORK STOCK EXCHANGE.

(See p. 149)

| MONTH END DATA. | 1947 February. | 1946 February. |
|--|-------------------|-------------------|
| Shares Listed (Mil.) | 1,786 | 1,620 |
| Share Issues Listed (No.) | 1,343 | 1,278 |
| Par Value of Bonds Listed .. (Mil. \$) | 137,106 | 139,299 |
| Bond Issues Listed (No.) | 925 | 978 |
| Total Stock and/or Bond Issues .. (No.) | 1,203 | 1,180 |
| Market Value of Listed Shares .. (Mil. \$) | 68,839 | 74,165 |
| Market Value of Listed Bonds .. (Mil. \$) | 141,033 | 146,524 |
| Market Value of All Listed Securities (Mil. \$) | 209,872 | 220,689 |
| Flat Average Price—All Share Issues A (\$) | 52.44 | 61.12 |
| Shares: Market Value—Shares Listed A (\$) | 38.55 | 45.79 |
| Bonds: Market Value—Par Value A .. (\$) | 102.85 | 105.19 |
| Stock Price Index (12/31/24=100) AB (%) | 81.1 | 92.6 |
| Member Borrowings on U. S. Govt.'s Issues (Mil. \$) | 86 | 369 |
| Member Borrowings on Other Collateral (Mil. \$) | 205 | 440 |
| Per cent of Market Value of Listed Shares (%) | 0.30 | 0.59 |
| Member Borrowings—Total .. (Mil. \$) | 291 | 809 |
| N.Y.S.E. Members Branch Office .. (No.) | 901 | 858 |
| Total Non-Member Correspondent Offices (No.) | 2,609 | 2,438 |
| Customers' Net Debit Balances CD. .. (Mil. \$) | 573 | 1,046 |
| Credit Extended on U. S. Govt. Obligations (Mil. \$) | 66 | 172 |
| Customers' Free Credit Balances CD. (Mil. \$) | 681 | 755 |
| DATA FOR FULL MONTH. | | |
| Reported Share Volume (Thou.) | 23,758 | 34,093 |
| Ratio to Listed Shares (%) | 1.33 | 2.11 |
| Daily Average (Incl. Saturdays) .. (Thou.) | 1,080 | 1,623 |
| Daily Average (Excl. Saturdays) .. (Thou.) | 1,132 | 1,711 |
| Total Share Volume (Incl. Odd Lots) F (Thou.) | 32,468 | 51,851 |
| Money Value of Total Share Sales F .. (Thou. \$) | 942,966 | 1,573,357 |
| Reported Bond Volume (Par Value) .. (Thou. \$) | 79,987 | 129,337 |
| Ratio to Par Value of Listed Bonds .. (%) | .058 | .023 |
| Daily Average (Incl. Saturday) .. (Thou. \$) | 3,636 | 6,159 |
| Daily Average (Excl. Saturdays) .. (Thou. \$) | 3,821 | 6,624 |
| Total Bond Volume (Par Value) F .. (Thou. \$) | 95,349 | 146,310 |
| Money Value of Total Bond Sales F .. (Thou. \$) | 68,979 | 110,162 |
| N.Y.S.E. Memberships Transferred .. (No.) | 2 | 3 |
| Average Price (\$) | 64.000 3/14/47 | 56.000 3/15/46 |
| Shares in Short Interest F (Thou.) | .... | 1,016 |

new capital gains tax. In countries where even necessities are taxed by means of a sales (or turn-over) tax, there is absolutely no justification in keeping share transactions free from such tax. Especially, if, as has been recommended above, the transfer duty is to be lowered, there is every justification of raising revenue in some other way.

69. In most European countries, a turn-over tax is raised on stock market dealings, and this brings a fairly large revenue.

70. I, therefore, recommend that a sales tax on share transactions should be levied every time a scrip is sold. The proper procedure will be for every member of the stock exchange to submit a list of his sales every evening to the committee of the stock exchange with a full amount of tax as fixed by Government. The tax may be levied at either 1% of the market value of the shares sold or 2% on the par value of the shares whichever is higher.

71. This tax may not be regarded as serious burden and will be passed on to buyers just as sales tax is now passed on. An advantage of this tax is that it will also be a curb upon speculation but a premium on investment. Those who speculate on shares will have to pay duty several times over and over again, but the investor will have only a light burden. At the same time the burden on the speculator is not heavy enough to discourage him altogether. Therefore, it may serve as an elastic source of revenue. Of course, the tax will have to be levied not only from members of the stock exchanges but also from private dealers. Strict provisions will have to be made for this in the regulation of the over-the-counter market.

72. The exact yield of this tax cannot be estimated, but in the years 1945 and 1946, when speculation was at its height, this might have yielded many crores. Whatever be the yield, it should not only maintain the establishment required for controlling the stock market, but should also make a contribution to the general revenues.

Conclusion

73. It may be clear from the foregoing that for deciding on the various complicated issues connected with the regulation of the stock market, a high-powdered semi-judicial authority, as recommended in Chapter XI, will be essential. In the absence of such an authority, neither the Central Government nor the Provincial Governments will be able to tackle seriously the many blemishes that are now impeding the proper functioning of the stock market. Quick enquiries and prompt decisions and a firm determination to carry out the decisions will be necessary if regulation is to be real; only a high-powered commission like the S.E.C. of America can effectively carry out such work. Further, the stock market cannot be properly regulated without at the same time bringing under regulation the registration of companies, capital issues and the administration of company law as a whole. This has been made amply clear in several chapters (especially VII, VIII, X and XI). There is at present a control of capital issues, but four years' experience of that control has shown that if our objective is to ensure safe investment and to attract abundant savings into industry and not merely to control inflation, as in war time, a great deal more than has hitherto been done will be necessary, and this would involve more systematic control both at the capital issue stage and subsequently. Similarly the inadequacy of the present scrutiny of companies' financial condition has also been made clear. It is certain that

a control of one stage of the investment market alone is bound to be ineffective. If any control is to be attempted, it must be a comprehensive one covering the different stages. This is borne out by the experience of other countries, not only the U.S.A. but the U. K. as well. This latter country which had long been depending on *laissez faire* has at last found it necessary not only to regulate stock market but also to introduce fuller control over the registration and subsequent activities of companies.

74. It is true that corporate enterprise has not made such progress in India as in the U. K. or the U. S. A. India is still in the stage of building up, but this fact offers no justification for non-interference. On the other hand, it supports the need for regulation, seeing that thereby this country could avoid some of the baneful developments of other countries which they are now struggling hard to rectify. Further, it is easier to regulate things at the initial stages : after vested interests have spread their tentacles it would be extremely difficult to rectify things in the national interest. In the U. S. A., the Securities Exchange Commission had to carry out a relentless fight against powerful vested interests and this has involved a great deal of unpleasant labour. In this country, investment in corporate enterprise is still in its early stages : and it is still possible to make this tender plant to grow in the direction we want without stifling it in a hot house. Tended in this way, the plant will grow to the fullest stature and yield the best fruits and most abundantly. This is the justification for the kind of regulation recommended in this report.

75. Although corporate enterprise has not yet developed to the extent indicated by the resources of this country, much progress has lately been made and as this has been going on without any real regulation, vested interests are under formation, if not already built up, as will be clear from many parts of this report. These interests are likely to feel keenly the intrusion of Government into a field which has so far been left to the free play of self-interest. But we must consider the national interest as our prime concern : it is not fair to allow the self-interest of a small group of individuals to stand in the way of changes which will benefit the much larger group of savers and investors and of corporate borrowers—all these being classes in whom an expanding economy like ours must be vitally interested. Further, if this is not done at this stage, there are chances of more drastic steps being found necessary later. One fears that, if the present trends are any indication, the very existence of corporate enterprise may be imperilled if the country comes under the control of a more radical ideology. It is therefore wiser for corporate enterprise to come under reasonable discipline now : for, thereby there may be a chance for it to survive, while otherwise, it runs the risk of being stifled.

76. Further, although at the start some strains and hardships may be caused by the introduction of regulation, its long run results are bound to be much more favourable. At present the benefits arising from the existence of an active and continuous market go very largely to the speculator and investor. On the other hand, it often involves genuine investors in serious loss. To the investors what is really important is not excessive activity and perfect continuity, but close conformity to real value. Therefore, the special pleading made for excessive activity in certain subsidized American writings and their Indian versions must be taken with a grain of salt. The reforms suggested in this report may bring about a slightly less continuous and less mercurial market. They may reduce slightly the easy profits now

reaped by speculators, but will encourage genuine investors more and more to put their money into corporate enterprise. After all, "We do not want markets for the benefit of speculators, but speculators for the benefit of markets."

77. As has been explained in Chapter V, the direction given to the flow of savings through the process of evaluating securities is one of the most essential economic functions performed in a capitalistic society. The machinery which regulates such a vital function cannot be left to be operated in the selfish interest of speculators ; it is the Government's duty to regulate such machinery in the highest national interest. The continued neglect of this duty has caused serious economic maladjustments in this country and has proved injurious to the public interest in many ways. Especially, if a planned economy is under contemplation, it would be unsafe to launch it without a careful regulation of the investment market. It is hoped that the urgency of such action will be fully realized and that a system of stock market control suited to India's conditions and requirements will soon be devised and carried out, in the best interests of our national economy.

CHAPTER XII.

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS.
Chapter I. HISTORY AND PRESENT POSITION OF THE
STOCK MARKET.

Although the first stock exchange in India was started in 1877, only three cities in India had stock exchanges, in 1933. Since then progress has been rapid, especially during World War II; today eight cities in Br. India have exchanges (and two in Indian States), and the number of stock exchanges in Br. India is 18, with a total membership of about 2,500. (Paras 3-24.)

The stock market in India is at present in a confused condition. In many of the leading cities of India there is a strange medley of stock exchanges, street markets and independent firms, all competing with one another for trade in the same securities—a situation which cannot arise and will not be tolerated in any civilised country today. Nor is each city confining itself to one stock exchange, as is the recognised custom in Europe and America; in two Indian cities there are as many as three or four stock exchanges working in the same street or mohalla, trading in the same securities and competing with one another. Another undesirable feature is that several of the stock exchanges permit trade not only in stock but also in bullion and commodities, thereby creating serious complications. (Paras 25 to 46.)

Chapter II. CONSTITUTION AND MANAGEMENT OF
STOCK EXCHANGES.

Stock exchanges in India are either unincorporated, private registered associations (as in Bombay and Ahmedabad) or joint stock companies (like the Calcutta Stock Exchange). While the membership of the former is acquired by the purchase of a card, the holding of a share is essential for the membership of the latter. The liability of most of the company exchanges is limited by shares; of two by guarantee. There are certain peculiar features attaching to the shares of the stock exchange companies. (Paras 3-8.)

Although some of the member-firms in Bombay and Calcutta can hold their own with similar firms in London or New York, the great majority of members of the Indian stock exchanges are ill-equipped for discharging the heavy responsibility falling on them as brokers, and as investment advisers of the public. (Para 17.)

Members of Indian stock exchanges are not divided into brokers and jobbers, and efforts in the past to raise up a class of jobbers have not succeeded. (Paras 21-23.)

Some of the members on the Bombay Stock Exchange do tarawani work; their business is of parasitical nature and causes excessive speculation. (Para 24.)

The speculative practices of remisiers or 'half-commission' men have also brought the stock market into disrepute. (Para 26.)

The managing boards of stock exchanges are elected once a year from among the members of the general body. On the Calcutta Stock Exchange separate seats are set apart for Europeans, Marwaris, Bengalees, etc. There is no outside representation on the governing boards of stock exchanges (except Hyderabad Stock Exchange). (Paras 27 and 28.)

Complicated problems have arisen in connection with the management of company stock exchanges, due chiefly to the directorate of

the company being also the managing board of the stock exchange (Paras 29 and 30.)

Only two stock exchanges in India have well-defined and fully written rules approved by a Government. Others have rules drawn up by the directorate of joint stock companies. There are yet other exchanges with partly written and partly unwritten rules. Outside markets work entirely under convention and usages. (Paras 32-37.)

The listing regulations of the Bombay and Ahmedabad stock exchanges are fairly complete. The Calcutta Stock Exchange has also got some listing regulations. In the case of other exchanges the securities to be traded in are decided by the governing boards. (Paras 38-41.)

Chapter III. THE SECURITIES, THEIR NUMBER, VALUE AND DISTRIBUTION.

The data available regarding Indian securities are inadequate, as no organised effort has been made to collect and collate them systematically. (Paras 1 and 2.)

The public securities traded in the Indian stock market are the Central Government Loans (non-terminable and terminable), Provincial Government loans, Municipal loans, Port Trust loans, Improvement Trust loans, Indian State loans, etc. (Para 4.)

Of the 14,859 companies working in March, 1945, with a paid-up capital of Rs. 388.97 crores, only issues (ordinary, preference, etc.) of about 1125 companies are listed on one or the other stock exchange. Of these, 1057 companies (1506 issues) have a paid-up capital of Rs. 270.40 crores. (Paras 6 and 7.)

On the Calcutta Stock Exchange are listed 864 issues (of which 647 are ordinary issues) of 629 companies. In recent years increase has been chiefly in regard to sugar mills, electrical companies, miscellaneous, etc. (Paras 13 and 14.)

Since the outbreak of World War II, security prices have risen about four times, the highest rise being in cotton textiles shares, jute shares, engineering shares, coal shares and chemical shares.

The aggregate values of securities, which stood at 55% above par value at the outbreak of war rose to 436% above par values in the middle of 1946, but have since fallen greatly. (Paras 16-19.)

It is not possible to state how the ownership of securities is distributed between different sections of the population. But it is certain that they are held mostly in the larger cities and by business or professional classes. (Paras 19 and 20.)

No doubt, more men of limited incomes have come to own securities lately, but no accurate data can be gathered regarding this. (Para 21.)

Chapter IV. OPERATION OF THE SECURITY MARKET.

While the stock exchanges of Calcutta (except one), Lahore (5), Nagpur and Delhi confine themselves to cash dealings, exchanges in Bombay, Ahmedabad, Madras and Cawnpore and one company exchange in Calcutta permit both cash and forward dealings. The curb markets generally follow the system in the nearby stock exchange. (Paras 3-9.)

There are divergences between stock exchanges in regard to the conduct of business, whether dealings are cash or forward. (Paras 12-19.)

Memos or notes are substituted for formal contracts and this has led to the evasion of contract stamps. The arrangement and procedure for settlement are found to vary between exchanges. (Paras 26 and 27.)

Provision for clearing now exists in Bombay and Ahmedabad exchanges and even there for some securities only.

The practice of budla obtains on Indian stock exchanges, in the case of forward dealings.

Transfer of securities in India involves expenditure at every stage, by way of stamp duty to Government and transfer fee to the company. This has brought about the prevalence of blank transfer which is the recognised practice. (Paras 30-46.)

Margin trading is widely prevalent on Indian stock exchanges. (Paras 47-51.)

Chapter V. SECURITY MARKET AS IT SHOULD BE.

The stock market is an essential concomitant of the capitalistic system of economy and can be helpful in giving mobility to the property represented by stocks and bonds. A well-regulated stock market can also serve as a barometer of general business conditions and could indicate the economic prospects of the different industries in the country. It is also necessary for the raising and management of the public debt. (Paras 2-6.)

Stock market gives securities the marketability and price continuity necessary to serve the need of investors. (Paras 8-10.)

It can also correctly evaluate securities according to their investment worth. (Paras 11-13.)

Security market can provide safety for and equity in dealings. (Para. 14.)

It can also induce, direct and allocate the flow of savings into the most productive channels. (Paras 15-20.)

Speculation is useful in making the stock market to perform the above functions. Only by speculation can a large and continuous volume of transaction be provided. (Paras 21 and 22.)

But the importance of speculation has been exaggerated by a host of American writers, many of whom wrote to further the interests of the New York Stock Exchange. These ideas have found their way into India. (Para 23.)

Most of the arguments used for justifying speculation in commodities are not applicable to speculation in stock. Stock does not grow like corn in fields, subject to weather conditions and is not marketed in certain seasons and need not be rationed for the benefit of consumers in times of scarcity. Speculation in the stock market stands on more slender grounds. (Para 24.)

Speculation is liable to be misused and is frequently misused by the activities of unscrupulous manipulators and ignorant 'outsiders,' and the result has been violent and sudden fluctuations in stock prices and thus all the objects of the stock market mentioned above are being defeated. When speculation thus runs riot, it may have serious repercussions on the credit system and on the stability of institutional investors. The Wall Street crash of 1929 and the banking crisis of 1933 in the U. S. A. demonstrate the fatal results of misdirected speculation. (Paras 25-30.)

Speculation has therefore to be carefully controlled in the public interest and stock market must be so regulated as to prevent speculation from running riot. (Para 31.)

How should the stock market function in respect of legal position, membership rules, conduct of business, broker-customer relations etc. (Paras 32-40.)

Chapter VI. SECURITY MARKET AS IT IS.

There has been widespread criticism of the working of the stock market in India. The principal criticism is that wild fluctuations have taken place in stock prices and have thus defeated the purpose of speculation. (Para 1.)

As in other countries, there is an inclination on the part of stock exchange authorities, when things go wrong in the market, to throw the blame on outsiders. (Paras 2-5.)

(a) Stock Exchanges.

The main defect of the Indian stock market is in the system of settlement in force—differencing, and postponement of contract by *budda*. These lead to excessive speculation and over-trading. (Para 6.)

Easy credit facilities in the form of margin trading, blank transfer and indiscriminate advances of money by certain banks and money-lenders also lead to over-speculation and endanger the credit structure. (Paras 8-10.)

Private compromise has been a serious cause of over-speculation on Indian stock exchanges. (Para 11.)

"Put through" business prevalent on the exchanges, has been a potent cause of manipulations and has brought about various other evils. (Paras 12-15.)

Although both cash and forward markets are subject to speculation, it can become excessive more easily and is more liable to get out of control, in the forward market. (Para 16.)

The excessive speculation on the Bombay market cannot be dissociated from the forward dealings practised there. (Paras 17 and 18.)

Safety for and equity in dealings has not been provided for on most exchanges in India and this has greatly undermined the usefulness of exchanges. (Paras 20-23.)

Most exchanges in India have been lax in enforcing their rules. The Calcutta Stock Exchange calls for much reform in this respect. (Para 25.)

The governing boards of stock exchanges are generally unwieldy and ineffective. (Para. 26.)

Nevertheless, it cannot be denied that the stock market has helped in maintaining continuous marketability to a certain number of securities, although this has often been at the expense of correct evaluation. (Para 27.)

(b) Street Markets.

The street markets (*curbs*) have greatly expanded their business in recent years, although they have no legal status, nor competent to exercise any discipline. (Paras 28-30.)

Street markets have been greatly instrumental in lowering commercial morality in the stock market. Fraudulent practices abound in them. They have greatly been instrumental in bringing about rapid fluctuations in share prices, and in undermining the discipline in the organised stock market. (Paras 32-37.)

(c) Outside Brokers.

Outside brokers have also captured a great deal of business in recent years. They have collected vast funds and have roped in a large number of persons into stock market speculation. (Paras 38-43.)

Some of the outside brokers work as agents of stock exchange member-firms. (Para 44.)

These outside brokers often carry out manipulations in the stock market. By their sharp practices, they have mulcted many innocent people of their hard-earned money. (Paras 46 and 47.)

Many of them carry on speculation in commodities as well as stock, and are able to make large profits by turning from the one to the other, according to immediate prospects. They also carry on arbitrage transactions. (Paras 48-52.)

(d) Manipulations by Outside Operators including Company Directors and Promoters.

Manipulations by outside operators have been common in India. The best example is the Indian Irons share boom in 1937. (Paras 53 and 54.)

Company promoters have been defrauding the public by "stagging" in one form or another. Prices have been pushed up or down to suit their nefarious designs. (Paras 56-59.)

They have also employed various devices to keep voting power in their hands and to undermine the powers of the share-holders. (Paras 60-62.)

Directors and other officers of companies have been using 'inside' information for speculating profitably in their company's shares to the detriment of the investing public. (Paras 63-65.)

Chapter VII. ECONOMIC RESULTS OF THE INDIAN SECURITY MARKET.

In judging whether the stock market in India has fulfilled its functions, we have to study first the trend of security price fluctuations. A study of the price data discloses the prevalence of 'wide and wild' fluctuations in stock prices. Fluctuations in India are found to be much wider than in other countries. (Paras 2 and 3.)

An analysis of the aggregate prices of ten leading securities shows that prices have behaved erratically. (Paras 4-8.)

The effect of price fluctuations is best exemplified in the period after World War II when a boom in stock prices was followed by a slump. (Paras 9-11.)

The violence of stock market fluctuations in India calls for special concern. (Paras 13 and 14.)

There is no proper safety for stock market dealings in India; nor equity between parties. (Para 15.)

It is also doubtful if the stock market has helped in fulfilling the function of directing the flow of savings into the most productive channels. (Para 16.)

Large funds have in recent years gone into joint stock enterprise, but this is not so impressive having regard to the vast increase in money incomes in war years. On the other hand, the sharp practices of company promoters and directors and excessive fluctuations in stock prices have discouraged investment in corporate enterprise. (Paras 17 and 18.)

Speculation in the stock market has been potent factor in the inflationary situation in India in war-time and after. (Paras 19 and 20.)

Bank advances for stock dealings have greatly increased in recent years; the banking crisis at Calcutta in the middle of 1946 was due to too liberal advances on stocks. (Paras 21-24.)

Widespread tax evasion has been going on under contract stamps, transfer stamps and income-tax. (Paras 25-28.)

In the result the stock market in India has failed to fulfil to any reasonable extent the functions which are expected of it. This is chiefly due to two causes, namely, lack of experience and training among the great majority of stock brokers and a general craze for speculation and gambling among certain classes of people in this country. Even those of them who have taken lately to industry have not shown so much interest in making production efficient as in profiting by clever company floatations and speculative share transactions. Paras 30-34.)

Chapter VIII. SHOULD THE SECURITY MARKET BE REGULATED ?

The abolition of stock exchanges or even of all speculation is not advantageous as dealings are bound to go on unregulated and therefore more harmfully. The only alternative is wise regulation. (Paras 1-4.)

The opposition to regulation on the ground that it is an invasion of private rights is unjustified, having regard to the important repercussions of the stock market on the banking system, credit structure, trade and commerce and general economic security of the country. The stock market is a barometer of general business conditions and is a powerful influence both as a depressent and as a stimulant of business activity. To leave in private hands, which means in the hands of speculators themselves, an institution so closely intermeshed with the gears that drive the wheels of industry and commerce is a serious omission of public duty. (Paras 5-9.)

Another line of criticism is that Government is not properly equipped for exercising intelligent control. The lie direct to this has been given by the outstanding success of the Securities and Exchange Commission in U. S. A. (Paras 10-13.)

A third argument is that stock market control will hit industry, especially in the undeveloped state of India's economy. Yet Japan established strict control over the stock market as early as 1893 when the economic development of that country had only started. A regulated stock market would be great help to carry out a healthy economic development. (Paras 14 and 15.)

Stock exchange authorities favour control, provided, of course, the control is on outside brokers and street markets and manipulators only. (Paras 16-19.)

They forget that stock exchanges also have blemishes. Clearly, some Central authority is necessary for preventing unlicensed persons or bodies from maintaining stock exchanges and for ensuring a reasonable uniformity between existing stock dealers in regard to rules of business. (Para 20.)

In the present circumstances, Government regulation must go further and tone down the excessive price fluctuations, especially in times of panic and political uncertainties as lately witnessed. (Paras 21-26.)

The ultimate aim of regulation must be to make regulation un-

necessary by strengthening the internal discipline within stock exchanges. (Para 27.)

Government regulation in Bombay since 1926 has been ineffective owing to serious defects in the law and the lack of a competent authority to administer it effectively. (Paras 23 and 29.)

War-time control of forward dealings under D.I.R. 94C has been even more ineffective owing to various causes. (Paras 30-32.)

Chapter IX. METHODS OF CONTROL IN OTHER COUNTRIES.

In other countries also stock markets had been in the past full of blemishes, but firm action taken by Government has greatly rectified them. (Paras 1 and 2.)

In London the regulation is largely confined to outside dealers whose sharp practices had in recent years evoked public criticism. There has not been any need for stringent regulation over the London Stock Exchange, but no other country is in this respect able to follow the British example. (Paras 3-7.)

In Paris, the main stock exchange (Parquet) is almost like a department of Government, members being appointed by the President of the Republic and the managing board working under the supervision of the Ministry of Finance; the supervision of Government extends also over the curb market and the free market. (Paras 8-12.)

In Germany stock exchanges are subject to very detailed Government regulations. On the Berlin Stock Exchange a State Commissioner appointed by Government is responsible for administering all laws and regulations. (Paras 13-15.)

In Tokyo Government regulation of stock market is even more complete. Government approval is necessary for the appointment of all stock exchange officers, and Government has power even to inspect the books of the exchanges and of the brokers. A guarantee fund has also to be deposited with the Government by every exchange. (Paras 16 and 17.)

In the U.S.A. Federal legislation started only in 1934 after a widespread public agitation for the same. Since then a comprehensive regulation has been carried on by a high-powered body, the Securities and Exchange Commission. This Commission administers not only stock exchange law but also company law and the laws relating to public utility-holding companies, trust indentures, investment companies, investment advisers, etc. There was considerable opposition to Government supervision when it began, but subsequently, harmonious relations have prevailed. (Paras 18-23.)

Conversion of the stock market into a semi-Government department as in France is not recommended for India, but comprehensive supervision is essential. We may draw many lessons, especially from the U. S. A. (Paras 24-26.)

The position of the stock market in India today has much in common with that of the American stock market before 1934. (Paras 27-36.)

Chapter X. NATURE OF REGULATION

Regulation in India must cover the entire market, stock exchanges, curbs and private dealers. Manipulations must be controlled by various methods. Dealings in the shares of a company by its own directors and agents must be regulated, as also the share pushing activities of promoters at the flotation stage. The aim of regulation is

the setting up of a competent authority to administer the law. Mere legislation and leaving it to be administered by Provincial Government is bound to be futile in rectifying matters. (Paras 2-4.)

It is here that the example of the U. S. A. is most helpful for us. Effective action has been taken in America to put down manipulations, to discourage the unfair use of inside information by company directors, to control the over-the-counter markets and to reorganise exchanges and this entire work has been done by the Securities and Exchange Commission. (Paras 5-18.)

The problem in India is analogous. Provincial action cannot be effective as a large part of the trade is in inter-market counters, as manipulations and pool activities operate on an all-India scale. Further, the uniformity in rules of business is essential and not to have this would only drive business from regulated to unregulated markets. To leave the administration of such a matter to the Provincial Governments will therefore defeat the objective in view. They will be helpless in carrying out the urgently needed reform. (Paras 19-21.)

Nor has any existing department of the Central Government the convenience or equipment to carry out this work. Only an independent and quasi-judicial authority with fullest powers of supervision could discharge this work effectively. A National Investment Commission is therefore necessary. (Para 22.)

The planning of investment on the lines proposed by the Finance Member (Sir A. Rowlands) is neither feasible nor urgent; even in the U. K. a similar proposal had to be shelved; what is urgent in India is to make investment safe, in the interests of social justice as well as of attracting more of the year's savings into corporate enterprise, rather than be hoarded as formerly. Therefore, to attempt a balanced investment in the altogether confused and insecure state of the investment market in India is like putting the cart before the horse. (Paras 23-26.)

The first step must be basic legislation in regard to stock market regulation. The stock market has not been expressly mentioned in the Central, Provincial and Concurrent list of the Government of India Act, 1935. Assuming that it comes under the provincial head, trade and commerce in the province, permission from the Provincial Governments has been obtained by the Central Government to legislate under Section 103 of the Act. But, if this will not empower the Centre to administer the law, the very object of legislation will be defeated, and therefore, the right step will be to seek a declaration by the Governor-General under Section 104 of the Act thereby placing stock dealings in the Concurrent list. (Paras 27-33.)

The legislation urgently needed is to empower the Government of India to (i) regulate the stock market by licensing stock exchanges and other dealers in stocks, and to make rules and bye-laws, (ii) to register securities seeking to be enlisted on the stock exchanges and insist on certain periodical returns regarding them, (iii) to impose restrictions on budla, blank transfer and other objectionable practices, (iv) to administer laws relating to the securities trade, by setting up suitable agencies for the purpose, (v) to fix margins for stock dealings from time to time, (vi) to call for books of member-firms, and to examine the financial position of, and call for explanation from brokers and (vii) to levy a sales tax on sales of stock. (Para 34.)

For assisting the Commission or other authority set up, it may be advisable to have a standing Council of Stock Exchanges, composed of representatives from leading stock exchanges. (Para 35.)

among the powers of the Union in the Constitution to be soon drawn up. (Para 37.)

Chapter XI. LINES OF REGULATION—PROPOSALS.

If it is decided to have a National Investment Commission, that body must be entrusted with the drawing up of rules and regulations. (Para 1.) P 121-153

No rigid control of stock exchanges is recommended. Regulation must be such as to impose responsibilities upon the stock exchanges themselves for the discharge of their functions, Government intervening only when necessity arises. (Para 2.)

Unfortunately this objective cannot be immediately carried out as the existing stock exchanges are not properly organised and as street markets and independent firms have also to be brought under control. (Para 3.)

No competing stock exchanges should be permitted in the same city or town. This is considered axiomatic in Western countries, but vested interests have got entrenched in India, by the prolonged indifference of Government. Arguments for maintaining competing exchanges in the same town are absolutely untenable. (Paras 7-12.)

All stock exchanges, curb markets and independent firms, if any, should be licensed and in future no such concern should be started without taking out a licence. (Paras 13-15.)

Stock Exchanges need not be incorporated. There is no special advantage in organising stock exchanges as joint stock companies. (Para 17.)

Rules of business of Stock Exchanges must be uniform throughout the country. Some basic rules regarding the securities to be provided by members should be stated in the Act. (Paras 18 and 18A.)

Suitable outside representation, wherever possible, may be provided on the governing boards of stock exchanges. It is also more necessary to place the presidents in a more independent position that he may be able to safeguard the interests of the public against the self-interest of members. (Paras 19 and 20.)

Powers of the governing board in regard to suspension of the selling out and buying in rules, etc. must be specified and wherever necessary, necessary provision must also be made for Government consent being obtained under certain conditions. (Paras 21-26.)

No strong case has been made out for the continuance of forward market, with provision for *Budla*. On the other hand, there are distinct advantages in having an exclusively cash market as in New York. If the forward market is to continue, it must be only in a few selected scrips, and must be under strict control. (Paras 28-31.)

Ready delivery contract must be strictly defined and only in exceptional circumstances should any extension of the period be made. (Paras 32-34.)

Strict listing regulation must be enforced on all stock exchanges. (Para 35.)

Provision must be made for compulsory margins. The actual percentage of the margin must be decided by the National Investment Commission in consultation with the Reserve Bank. (Paras 36-43.)

Margin must be prescribed also in respect of bankers' advances on stocks and shares. This is primarily the concern of the Reserve Bank. (Para 44.)

It may not be practicable to separate brokers and jobbers on Indian stock exchanges, but it is necessary to strictly regulate (especially)

the dealing activities of the members in the public interest. Members should be prohibited from trading with their clients as principals. Provision for this may be made in the Act. (Paras 45-47.)

A schedule of minimum brokerage should be fixed and enforced. (Para 48.)

A period of apprenticeship and training must be provided as a necessary qualification for membership. A diploma on this subject in the Universities of Bombay and Calcutta may be desirable. As on the London Stock Exchange authorised clerks must be given opportunities for training and a few memberships may be set apart for them. (Paras 49 and 50.)

The number of holidays on the stock exchanges must be curtailed. (Para 51.)

Clearing Houses must be attached to all stock exchanges. (Para 52.)

It may be difficult to make blank transfer bad delivery, but its currency may be limited to two months. (Paras 54 and 55.)

Over-the-counter market must be regulated under rules somewhat on the lines of the Prevention of Frauds (Investments) Act of the U. K. (Paras 58 and 59.)

However strict the listing regulations may be, only by a reform of the company law and by proper administration of it can the mal-practices in the investment market be seriously tackled. Provision must be made for a close scrutiny of the underwriting and first sale of company shares, and of the share transaction of directors and other officers of companies. Various measures should also be taken for discouraging blank transfer and allied evils. (Paras 60-62.)

Provision must be made for the regular supply of statistics and for their being tabulated and published periodically. (Paras 63-67.)

The cost of administering the law must be met largely from the licence fees for registration, but it may be desirable to levy a sales tax, at low rates, on all share dealings, the proceeds to go largely to Provincial Governments. (Paras 68-72.)

For carrying out such a comprehensive reorganisation of the stock market, a high-powered and semi-judicial authority like the S. E. C. of America is essential, especially if regulation of the whole investment market is to be attempted. (Paras 73-75.)

Whatever may be the short-term results of the proposed regulation, its long-term results are bound to be of great value, especially if any planned economic development is to be carried out. (Paras 76-77.)