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Capital Market in a New Phase

Implications of Budget and Bank-rate cut Analysed

With the new package of fiscal and monetary measures the capital market appears to have entered into a new phase. The long spell of gloom seems to be receding and the stock markets have evidently gathered a lustre. Market analysts have hinted a major breakthrough and an 'upswing' is conjectured to be in the offing.

The initial push was provided by the fiscal measures contained in the Budget for 1968-69. In fact, there had been calculated anticipations about the emollients and spurs in the Central Budget and share values had been responding well to these expectations till, on the pre-Budget eve, a jolt was administered to them by the news of a large uncovered gap which might impell the finance minister to sharpen his fiscal instruments. Since this latter apprehension did not come out to be true share values restarted their career of ascendancy. However, budgetary props may fizzle out if the market lacks resilience being placed, as it were, in a morbid economy. This actually happened with the 'bonus-boom' generated by an abolition of the tax on bonus issues as well as the national capital gains tax thereon announced in the 1966-67 budget. Although the 'boom' did not exhaust far too soon it certainly failed to permeate the whole gamut of the capital market, which, by and large, remained pensive. Hence, the current budget has initiated a chain of measures that must aid recovery. Lest the capital-market-oriented fiscal feat should be repulsed by the entrenched recessionary forces plagueing the industry for quite some time now, it has been supplemented by the strategic cut in the bank rate. The cumulative impact of the 'fiscal-monetary twins' may be anywhere near a smart and enduring recovery of the capital market. Although it may be in the nature of an 'adventure' to attempt to prognosticate the precise effects of the recent fiscal and monetary climate on the stock and the new issues markets, an endeavour may be made to gauge the approximate overall results atleast in the short run. It is, therefore,

proposed to discuss the different measures recently announced to brace up the investment climate and to pinpoint the extent to which they may prove fructuous.

It may be convenient to classify these measures under two broad categories : (A) FISCAL ; and (B) MONETARY.

FISCAL MEASURES

Budget proposals affecting the entire scheme of taxation have got a bearing on the capital market by touching two significant tax entities viz., the individual and the corporate business units. Since, both have important contributions to national savings to be channelised into productive investment through capital market agencies, fiscal incentives or deterrents have got a significant role to play. The 'individual' saves, offers his savings in response to favourable stimulii and, among the numerous alternatives, the one that he would choose, subject to adequate inducement, is the corporate investment. This would align the two tax entities and if the corporation is allowed to reciprocate the 'saving and channelisation efforts' of the individual through improved 'distributions' a strong capital market nexus may, perhaps, be developed. This could perhaps be the basis for evaluating the Budgetary proposals for 1968-69 vis-a-vis their impact on the capital market.

The individual fiscal measures may now be examined in the light of the foregoing assumption :—

Corporate Taxation—The two most important reliefs provided in the Budgetary proposals for 1968-69 include :

(a) Reduction in the surtax on corporate profits from 35% to 25% with effect from the assessment year 1969-70, and

(b) Abolition of the Dividend tax on distribution of dividends by companies in excess of 10%.

The surtax reduction would directly aid companies in declaring higher dividends by releasing greater profits for the purpose. But the long-term gains accruing to the capital market from this may be circumscribed for two reasons. *Firstly*, it may not be accompanied by liberal dividend policies and the 'capital hungry' industrial establishments might be tempted to 'plough back'. *Secondly*, although this conservatism at dividends might generate internal resources the same may push the stock values in reverse gear. Thus, the enduring gains are conditioned by the fact of a genuine transmittal of benefits that may arise from a freeing of the profits per reduced tax liability to the shareholder.

The discontinuance of the dividend tax should normally mean a landmark in extricating the market from the morass of declining capital values. But here again, the great limitation is whether corporate managements would voluntarily decide for an 'upshot' in the dividend rates beyond the erstwhile ceiling of 10% pegged under pressure of a tax deterrent. Even if it is presumed that advantage shall be fully taken out of this relief the gain shall be only marginal. A study by the Economic Times has disclosed that it would be somewhere in the neighbourhood of Rs. 2 crores, and about two-thirds of the sample 179 companies would benefit by less than Rs. 50,000 each. Although, calculations in this study have been made on the hypothetical presumption that the dividend distributions for this purpose were to continue approximately at the same level of "excess" as observed during the latest year for which data were available, the following table would indicate a fairly dependable estimate of the magnitude of the gain to the different companies included in the sample :

Distribution of Companies According to Amount of Dividend Tax Liability in the Latest Year

Dividend Tax Liability (Rs. lakhs)	*No. of Companies**
0·1—0·5	126
0·6—1·5	25
1·1—2·0	15
2·1—3·0	5
3·1—4·0	3
4·1—6·0	4
Above 6·0	1
Total	179

[Source : Economic Times, 8th March, 1968]

*The sample has been extracted out of about 600 companies which would benefit from the proposed measure and covers most of the large listed public limited companies and also a few unlisted companies.

It would be apparent from the above that a large number of companies (the number would further increase if a census enumeration of all the 600 companies had been undertaken) would derive only a small benefit. A few companies would, however, get the substantial proportion of the total benefit. The first five (ranked in order of the magnitude of

the benefit) would be : Burmah-Shell Refineries, Century Spg. & Wvg., New India Assurance, Telco, and Tisco. It may be pertinent to observe that the concentration of the benefit in some of the 'blue chips' may have the effect of raising their market values and might cast the net of their influence far wider than could, perhaps, be anticipated. On a net basis, therefore, the discontinuance of the dividend tax might have the effect of improving the capital market climate (unless offset by countervailing forces e. g., slack demand, low industrial activity, continuing spell of recession, weak market psychology etc.) despite a wide 'scatter' of the small total benefit over smaller companies.

Personal Taxation

A direct prop to the capital market in this category of tax proposals is the provision of a blanket exemption limit of Rs. 500 in the case of dividend income. Although this may be welcome as a relief by all share investors, it is more likely to operate as an inducement to stock investment at lower levels and in the case of smaller investors. Viewed in this light, it may not be treated as a fiscal innovation to provide a tax exemption since the 'expanse' of the relief has just been broadened to cover even stocks holders whose dividend incomes exceed the erstwhile ceiling of Rs. 500.

Indirect boost to capital market activity may be provided by the scrapping of the Annuity deposit scheme and the abolition of separate surcharges on earned and unearned incomes. It has been estimated that the Annuity Deposit Scheme would, after discontinuance, leave about Rs. 17 crores with middle class and high income communities and the same may find their way to the capital market only if the latter shows definite signs of a resuscitation and if adequate incentives are provided to the investors concerned. The elimination of the surcharges may also augment the investible resources of the richer classes of persons and may encourage a more brisk investment activity. Since, all these are only ancillary measures for the capital market, they may be expected to build up the impact only gradually. However, they might stimulate savings, a part of which might be siphoned off by the proposed public Providend Fund Scheme. This latter may aggravate the feud of resource allocation between the public and the private sectors, which has to be resolved with a more charitable attitude towards the languishing capital market.

MONETARY MEASURES

The cut in the bank rate from 6% to 5% has ushered in an era of cheap money policy, almost universally hailed by industry and investment

circles. A lower bank rate is conducive to the formation of an efferves-cence in the market due to the following reasons :

1. *It may realign the interest rate structure* with considerable benefit to the borrowers. Yield rates follow the restructuring of interest rates at lower levels and improve the 'payout' position of corporate dividends.

Yield rates may either be patterned after the market behaviour or may be forged by bank rate changes. Generally, the lead provided by the Central Banking authority is a significant positive 'pace-setter'. A Bank Rate cut has the effect of even revolutionising the interest rate structure and consequently the yield pattern.

The following table depicts the concurrence in the movements of both the yields and the bank rate :

Table showing Average Yields and Bank Rate Changes

Years	*Average Yields*	*Yield I. Nos.* (Jan. 6, 1961=100)	*Bank Rate*
1961	6.31	97.0	4%
1962	6.14	97.3	4%
1963	6.59	103.3	4·5%
1964	6.68	104.7	5%
1965	7.85	123.6	6%
1966	7.85	123.0	6%
1967	7.88	123.4	6%
1968 (1-3-1968)	7.84	—	6%
1968 (29-3-1968)	7.42	116.3	5%

It may be manifest from the above data that a reduction in bank rate was invariably accompanied by a general fall in yield rates. It is amusing to note that the average yield declined to 7.84 on 1st March, 1968 just on the anticipations of a possible reduction in bank rate. The actual bank rate cut on 2nd March, 1968 produced the sensational stir in the market and yield rates tumbled down to 7.42 on 29th March, 1968 and also pushed the Yield Index down to 116.3 as compared with 116.8 a week ago.

2. *It may improve the share values :* Lower yields, restructured by a bank rate cut, push up the share values and the two forces i. e., low yields and ascending values then act and react upon each other to finally culminate in a high level of buoyancy to the market. The bank rate cut to 5%,

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two days after the presentation of the Union Budget for 1968-69, had the effect of 'spurting' share values. The E. T. general index of ordinary share prices since February 14, 1968, when the upsurge started, recorded an improvement of more than 11% which compares very favourably with a decline of more than 2% during 1967 and a rise of about 13% during 1966. It may be of interest to note that the increase has been most spectacular since a major part of the advance took place just in one day when the index moved by 6·4 points to 111·5 and set up a new level for the current year.

The process of advancing share values initiated by favourable anticipations in market circles about the budgetary outlook and by the welcome actual budget proposals was considerably carried forward by the bank rate cut. What is of significance to note is that the cumulative impact of all the fiscal and monetary measures has been the imparting of strength to all sections of the stock market, including the cash shares, which implies that both speculative fervour and investment stamina have been built up. It may be of considerable interest to glean these tendencies from the following table recording movements in share prices between three dates viz., the day of commencement of the recent boom (14th Feb., 1968), the day next to the Budget day (1st March, 1968), and the day after the announcement of the bank rate cut (4th March, 1968).

Table Showing improvement in Share Values

Shares	*Values on 14-2-68*	*Values on Mar. 1, 1968*	*Values on Mar. 4, 1968*	*Rise between Mar. 1 and Mar. 4*	*Rise between Feb. 14 and Mar. 4*	
Bombay (Forward)	*Rs.*	*Rs.*	*Rs.*	*Rs.*	*Rs.*	%
Century	476·00	524·00	573·00	49·00	97·00	20·4
Kohinoor	156·00	181·00	196·00	15·00	40·00	25·6
Standard	412.00	450.00	492.00	42.00	80.00	19.8
A. C. C.	115.75	118.50	123.50	5.00	7.75	6.7
Indian Iron	15.04	15.56	16·24	0·68	1.20	8.0
Tata Steel	91.00	94.70	102.00	7·30	11.00	12.1
Telco	183·00	198·00	216·75	18.75	33.75	18.4
Scindia	12.72	13.08	14.56	1.48	1.84	14.5
Indian Dyestuff	175.50	191.00	219.00	28.00	43.50	24.8
Gwalior Rayon	20.88	23.36	25.70	2.34	4.82	25.1
Hindustan Motors	13.56	14.76	16.12	1.36	2.56	18.9

National Rayon	394.50	457.00	487.00	30.00	92.50	23.4
Premier Auto.	46.50	50.00	56.00	6.00	9.50	20.4
Bombay (Cash).						
Mafatlal Fine	290.00	310.00	325.00	15.00	35.00	12.1
Baroda Rayon	68.00	78.00	85.50	7.50	17.50	21.0
Indian Rayon	41.00	48.75	52.00	3.25	11.00	26.8
New India	48.00	52.50	57.00	4.50	9.00	18.8
Hind Aluminium	17.00	19.24	20·52	1.28	3.52	20.7
S L M Maneklal	127.50	155.00	157.50	2.50	30.00	23.5
T. Maneklal	240.00	285.00	320.00	35.00	80.00	33.3
CAFFI	35.60	40.00	44.00	4.00	8.40	23.6
NOCIL	119.00	122.50	127.00	4.50	8.00	6.7
Synthetics	73.00	80.00	85.00	5.00	12.00	16.4
Killick	128.00	180.00	200.00	20.00	72.00	56.3
Calcutta						
Guest Keen	12.90	13.90	15.65	1.75	2.75	21.3
Dunlop	21·85	23.10	24.90	1.80	3·05	14.0
Birla Jute	22.00	23.60	25.90	2.30	3.90	17.7
Ind. Aluminium	18.40	20.40	21.80	1.40	3.40	18.5
Union Carbide	25.37	26.87	27.75	·88	2.38	9.4
Ahmedabad						
Atul	202.00	215.25	234.75	19.50	32.75	16.2
Arvind	327.00	353.00	381.00	28.00	54.00	16.5
Calico	469.00	488.00	528.00	40.00	59.00	12.6
Ambica	532.50	568.50	648.00	79.50	115.50	21.7
Anil Starch	375.00	395.00	410.00	15.00	35.00	9.3
Delhi						
D. C. M.	29.62	30.81	32.00	1.19	3.62	12.2
Madras						
Travancore Rayon	12.25	13.60	14.85	1.25	2.60	21.2

(Source : Economic Times, 5th March, 1968)

Whereas the above figures record an all round increase ranging from 6·7% to 25.6% (in the case of Bombay forward), 6.7% to 56.3% (in the case of Bombay cash), 9.4% to 21·3% (in the case of Calcutta), and 9.3% to 21.7% (in the case of Ahmedabad), the increase was both the maximum

and most marked in the case of cash scrips. This points to the investment strength and the formation of an undercurrent of bullish sentiment, so essential for the advent and sustenance of an enduring boom in the market.

3. *It may lower down the cost of capital* :—The bank rate functions as the base rate for all interest rates on advances and also affects fixed dividend expectations similarly. With a high bank rate more alluring terms have to be offered to the investor even by companies of a superior rating. For example, when the bank rate was increased in 1965 to 6%, it was not possible to issue debentures at less than 7·5% and that too in the case of companies like the TELCO. The general rate was 7·75% and debenture issues at even 8% were noticed during that year. Similarly, the preferred dividends ranged between 9.3% and 10% except again in the case of TELCO which could issue preference shares at 9% during 1965. Moreover, the cost of loan capital must also diminish with a downward resetting of interest rates on advances. If an adequate availability of this low-cost capital is also ensured, it must have a salubrious effect on expansion plans and extended production resulting in increased buoyancy on production and profitability fronts. This may go a long way in restoring confidence of the investor and stabilising it at fairly high levels.

4. *It may affect certain specific sectors* :—Bank rate changes are likely to affect those undertakings where the permissible return is circumscribed by a ceiling and is at the same time tagged to a standard return with reference to the bank rate. Electric supply undertakings in India can earn 7% on their capital base as on 1st. April, 1965 and they may get the standard rate at 2% plus the Bank rate for any residue. A reduction in the bank rate would lower down the standard rate correspondingly but the actual impact would differ in individual cases, since the residual capital (after the capital base as on 1st April, 1965) would vary for most of them.

Impact on new issues market

The proposed fiscal incentives and the bank rate cut have, thus, made deep furrows in the investment climate hitherto prevailing in the capital markets of India. The integration of the fiscal and monetary measures has also influenced the new issues market. There is no doubt, that the new capital issues market is greatly aided by trends and sentiments prevailing in the stock markets in the short run because there is a perennial transmittal of impules from the latter to the former. But the long run capacity to absorb new issues with the least strain on the resources of underwriters is built up by the overall climate of saving, investment and production in the country.

Fiscal measures and monetary policy have great manoeuvrability to imparting this capacity by mobilising and drawing funds to the new issue market.

The immediate effect of the budget props to individual and corporate savings and the bank rate cut on the new issues market has reminded the developments during the boom of the period 1958-62 when several new companies were established and existing companies enabled to issue rights shares successfully. During that period, even relatively new companies were able to raise additional capital by issuing rights shares at premium even when they had not started production e. g., Synthetic and Chemicals which issued its rights shares at a premium of Rs. 20, although it went into commercial production in 1963, and Baroda Rayon which issued rights shares at a premium of 5% in 1961 although production was commenced only a year later.

Current examples symptomatic of the above developments include the new issues of Indian Explosives and BASF India. The Rs. 2·50 paid-up shares (Rs. 10 face value) of the former are being quoted around Rs. 4 and the Rs. 10 paid-up shares of the latter are being quoted unofficially at a premium of Rs. 4. The changing conditions appear to be influencing the existing companies desirous of entering into the capital market in the near future. Many of them have started thinking in terms of moderate to substantial premium on their flotations. Prospects for rights issue have also improved considerably e. g., in the case of ACC shortly to enter the market. Contrast this situation, for example, with the circumstance prevailing till recently when even Tata Oil had to raise rights capital at par only. What was distressing was that the very news of a rights offering depressed the shares concerned. The new environment for the capital issues market has remedied this demoralised state and has added to the strength of the market.

The foregoing analysis suggests that the stock and the new capital issues markets are approaching buoyancy and the recent developments, perhaps, indicate the rumblings of a boom. This is further borne out by the fact that the stock markets have braved the highly inclement financial weather on the globe and have also shown little anxiety for the much pronounced aid-uncertainties. What is now needed is an effective sustenace of this boom so that it does not wither away before making any sizable impact. Both the stock markets and the corporate entities have a role to play here. Stock exchanges must acknowledge the current circumstances as of a special character and must not rush forth to impose interim margins in the event of upward movements of prices beyond prescribed

limits. The Government of India must also appreciate the hazards of haste in this connection and it would be in the fitness of things if stock exchanges are permitted to apply their appropriate discretion. For the revival to stay longer, it is essential that corporate performance improves and the market receives all encouraging reports. So far, the performance reports are mostly in the nature of boosters. Among outstanding performance reported recently may be included Philips India, Hindustan Lever, Mahindra Electricals, Victoria Mills (despite the general crisis conditions for textile mills), Union Carbide, Chemicals and Fibres, Goodyear India, Dunlop Rubber, Ashok Mills and Arvind Mills (of Kasturbhai group), the Standard Mills and the New Shorrock Mills (of Mafatlal group), and the Finlay group of mills. However some of the adverse reports cover Bombay Dyeing and Buckingham & Carnatic Mills. Performance for 1967 of companies like the Century and the National Rayon is being anxiously awaited by the market, since they have a marked bearing on the market sentiments at least in the short run. Thus, the need of the hour is a more liberal dividend 'payout' to revitalise the investor interest, which if maintained at increasing levels, would greatly help in resuscitating the hitherto languid and pensive market.

Braj Kishor.