INTRODUCTION

Everything that needs to be said has already been said. But since no one was listening, everything must be said again.
- Andre Gide, French Author, 1947 Nobel Prize Winner

Those who forget history are doomed to repeat it- said Santayana. We have lived through and experienced turbulent times in the Indian capital markets, been a witness to several extreme events unfolding and creating volatility in the markets, also saw various measures taken to prevent recurrence of such events -and watched the markets grow amidst all the tumult. I wanted to share this unique story of Indian capital markets that are nascent in some ways, yet mature and resilient. This book has been taking shape in my mind for a while. And I thought sharing it with others, especially the younger generation, is vital for an insight into the future that lies ahead of them. India has very few books on its financial history and as the country is on the take-off stage to growth, it is all the more critical to learn about the past.

> *"Contributing to . . . euphoria are two further factors little noted in our time or in past times. The first is the extreme brevity of the financial memory. In consequence, financial disaster is quickly forgotten. In further consequence, when the same or closely similar circumstances occur again, sometimes in only a few years, they are hailed by a new, often youthful, and always supremely self-confident generation as a brilliantly innovative discovery in the financial and larger economic world. There can be few fields of human endeavor in which history counts for so little as in the world of finance."*

-John Kenneth Galbraith

In Christian belief, everything that happens is per God's will. If you do good deeds, you will be ensured of a seat in heaven. If your end objective is to go to heaven, there is a clear undisputed, path laid out. There are no risks – one achieves what one seeks.

In Greek mythology, men are pitted against Gods. Gods try to put hurdles in the path of men (and women). Those who succeed become heroes and are venerated on the same platform as Gods. In other words, you take the risks, you succeed and you get rewarded.

In Hindu mythology, there is no guaranteed reward for your good deeds. Whatever is ordained will happen, based on the deeds of your past lives and this one. If you do good deeds, you may be rewarded in next life or not at all. The holy book Bhagwad Geeta says: "You have control over your actions, not the fruits of your action. So do not be drawn to expectation, or inaction (2:47)." You act without expectation. The message is fatalistic. You take risks, you may succeed, yet not get the rewards.

Capital markets tend to act as a mix of all three philosophies with an added uncertainty about which philosophy is going to operate and when.

When Felix Baumgartner jumped from a helium balloon in the stratosphere at a height of 128,000 feet, everyone including Felix, knew it was risky. He was ensconced in a pressure suit to fight the changes in atmospheric pressure. As he jumped from that height he broke the sound barrier while hurtling towards earth[1]. He was the first man to do so in a free fall. At the end of the day, it was a commercial opportunity for him as the stunt was for promotion of an energy beverage and the risk taken was well worth the reward. Risk is thus both a matter of perception and an opportunity. What most people would perceive as a risk, a minority would consider as an opportunity. In that perspective, risk is a relative term and not an absolute.

But this book is not about individual accomplishments and risk taking capacities-it is about collective perception (or non-perception) of risks that likely end up creating a fortune for a few but may sink others. A reckless bull market can be laden with risk for most investors but would be an opportunity for the bears. The financial crisis of 2008, with its origin in the sub-prime mortgage market, ended up wrecking the global markets in its aftermath, bankrupted considerable number of individuals, companies and even put countries at risk. Yet, there were a handful who were perceptive enough to

1 Jonathan Amos. Oct 14, 2012. Skydiver Felix Baumgartner breaks sound barrier. www.bbc.com. Retrieved from: http://www.bbc.com/news/science-environment-19943590

recognize the risks and thereby the opportunities- and they made fortunes.

Reading history can impart lessons vicariously rather than learning through your own investing follies. One needs to go by the dictum 'what you know cannot really hurt you.' Knowledge of the past makes you better equipped to understand the present and prepare for the future. Howard Marks said in his 'Memo to Oaktree Clients':

> *"In deciding which future to prepare for, you need two things: (a) an opinion about what's likely to happen and (b) a view on the probability that your opinion is right. Everyone knows about the former, but I think relatively few think about the latter[2]."*

India and the World

In the internet age, as economic activity has gathered momentum,everything is inter-connected. Economies or markets that were earlier isolated, such as India, are now closely coupled with the global markets. Today, traders in Indian markets get up in the morning and check out on the closing of Dow or Nasdaq the previous night to decide on their trading strategy for the day. They also take a look at what is happening in the Asian markets that have opened ahead of India. Opening trades are more or less determined by movements in other markets, unless some momentous events have happened in the domestic markets. Currency trade is moving to offshore exchanges as well, and prices in these markets have a great bearing on prices in the domestic exchanges.

Prior to 1990, India was in a somnolent economic isolation. It had precious little interaction with the global economy for either investments, fund raising, or trading. The reforms of early 1990s changed all that. India opened up the doors to foreign investors as also for Indian companies to go overseas. The two-way fund movement over the last two decades has made sure that India is now solidly coupled with global economy. On the day after Brexit vote, Indian market dipped by 2.2 percent[3], even though Brexit is unlikely to have a direct impact on either Indian economy or Indian companies.

2 Howard Marks. June 20, 2012. Memo to Oaktree Clients. Oaktree Capital Management.

3 BSE website.

As a young country and even younger in capitalist ways, India has had to move at double speed to remain in sync with the rest of the world. Events beyond the borders of the country shape the economy of the country. Governments have a challenge in trying to anticipate the global changes while attempting to shape the domestic legal and financial framework. Seldom are the markets, regulators and the government prepared for shocks in the global economy. Sensex lost over 51 percent in the period May 2008 to Feb 2009[4] in the wake of sub prime mortgage led global financial crisis. The governments and markets were struggling to comprehend how a distant event with no apparent connection to India, could impact the market so much. They were dumbfounded as foreign investors exited in droves, selling over ₹49,000 crore (US $10.6 billion) of Indian equity in those10 months[5]. The equity prices dropped so low that they did not make any sense at all. Investors started flocking back to markets and buying up the battered down stocks. Sensex bounced back to 17711 in March 2010, rising over 105 percent from its levels a year ago. Foreign investors too started buying in, putting in ₹110,221 crores (US $23.2 billion) in 2009-10, which was close to the aggregate foreign portfolio investments in the preceding five years.

India is blessed to be a democratically governed country, holding elections regularly, fairly and successfully since independence. The institution of democracy is now firmly established in India and fully entrenched in the minds of its citizens. As a third world country, this is rather a unique phenomenon. A democratic political system certainly has its associated hazards while facing the challenges of governing a large populace with deficit resources. Operating in a democratic setup requires the government and authorities to strive for consensus, where the dangers of issues at hand falling into frivolous debate and creating unintended outcomes are quite real. The changes in governments, their politically inspired decisions, reckless growth of capital markets, have all contributed to risks in the capital markets. Governments and judiciary have both been at times originator of risks and mitigator of risks as well.

> "Some writers have pointed out that growth and development requires sound institution building and wise macro-economic policies, not a

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4 Ibid.

5 FPI monitor. NSDL website.

recitation of past injustices. I wish to stress that I agree. I do not look to history to absolve my country of the need to do things right today. Rather I seek to understand the wrongs of yesterday, both to grasp what has brought us to our present reality and to understand the past for itself. The past is not necessarily a guide to the future, but it does partly help explain the present."

– Shashi Tharoor, 'An Era of Darkness- The British Empire in India'

About the Book

This book is organized thematically. Organizing the events that have occurred thematically rather than chronologically order gives a cohesiveness to the narrative. Yet, there is a chronology maintained within themes. The narrative is fairly simple – First chapter discusses risks and various categories of risks. The second chapter takes you through the evolution of capital markets in India, beginning with post-independence period and arriving at present day, while the third chapter talks about the nature of risks in India. Some of the risks are unique to India, but most are extant in any capital market. The next section, from chapter four to chapter twelve takes up category wise discussion of risks that have emerged in India and takes the reader through significant events of the past and their impact on capital markets then. Lastly,in the chapter on Risk Mitigation, we take a look at the various initiatives taken to mitigate either the occurrence or impact of risks.

I know that this is only a discussion of matters after the fact. History in retrospect seems clearer than it ever is, when you are living it in the present. Learning about the past outlier events brings awareness that 'what is normal is often irrelevant' and alerts us to events that fall outside the bell curve. Of course, a book of this kind will raise numerous questions that elude answers. It would be left for the posterity to provide some of the answers. But it is vital that the reader, especially if he is an investor in Indian markets, raises these questions and attempts to find answers or solutions. For a foreign investor who is usually not familiar with the practices in an alien environment, it is essential to learn about the past and get an idea about the likely response or impact in case a similar event occurs.

The data is presented beginning with the year 1980. The data for the period 1980 to 1990 is necessary to place events after 1990 into right perspective. The S&P BSE Sensitive Index, more popularly known as Sensex, is used as a base for tracing the market movement. Any reference to index or stock market index is to the Sensex, unless otherwise stated. Mumbai was known as Bombay prior to 1995- for the sake of uniformity, it is always referred to as Mumbai, irrespective of the timeline. The measure of currency is Indian rupees ₹, except if mentioned otherwise. The numbers are stated in millions and billions for US dollars, and in lakhs[6] and crores for Indian rupees, to follow the conventional thinking. Figures in Indian rupees have been translated to US $at the average exchange rate in the relevant financial year. The US $ figures that appear in quotes from other sources have been cited as it is. Indian budget is presented and its accounts are prepared for the period from April to March and a financial year refers to that period.

A caution -this book does not have any claim to infallibility or to sagacity. There may well be facts of which I am unaware that weaken or discredit some of my arguments. By the time this book reaches in the hands of the readers, prices and indices mentioned in this book would have changed-markets move very rapidly. But I invite future readers of the book to place the facts in context of the events as they occurred rather than as they stand at the time of reading the book. This book is also not about to make any predictions. Our ability to predict future events is highly dubious; lulling yourself in to false comfort of knowing the future can lead to undesirable outcomes.

And to end with, a few quotes that I find appropriate in the context:

> There is nothing stable in the world; uproar's your only music. - John Keats, English Poet, 1795-1821
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> The risk of a wrong decision is preferable to the terror of indecision.– Maimonides, Jewish Philosopher, 1135-1204
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> The optimist proclaims that we live in the best of all possible worlds; and the pessimist fears this is true. – James Cabell, American Author, 1879- 1958

6 One lakh is hundred thousand, ten lakhs is a million, One crore is 100 lakhs or 10 million. 100 crore is a billion.