

Multi-Pronged Attempts Needed to Allure Small Investors into the Capital Market



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Institutional Investors (FIIs) and of promoters is progressively rising.

Low Level of Shareholding by Investors

According to the survey of Indian Investors by SEBI – NCAER, the number of equity investor households was almost halved from 12.1 million in 1998-99 to 6.5 million in 2000-01, representing a meagre 3.7 percent of Indian households. There has been no doubt some increase in the number of equity owners, thanks to the buoyancy, both in the primary and secondary markets. Even so the number of households owing equity as on March 31, 2007 may not exceed 8 to 9 million. This is duly reflected in the number of beneficial owners of demat accounts. As on March 31, 2007, NSDL and CDSL had 7.83 million and 2.42 million beneficial owner accounts respectively i.e., a total of 10.25 million accounts. This is inclusive of multiple accounts as also dormant accounts. In the light of this, it is difficult to place the number of individual equity owners above 15 million, which is just 1.5 percent of the population as against 15-20 percent in most of the advanced countries of the world.

It is really high time multi-pronged attempts are made to allure the small investors into the equity market so that fruits of the growth of the nation duly reflected in the growth of the stock market is shared by the common man.

Here are a set of measures that need to be considered in this behalf.

Percentage of Public Offer

Percentage of public offer a company has to offer to the public to be eligible for listing should be raised from 25 percent (and just 10 percent in cases where the offer exceeds a market value of Rs. 100 crore) to at least 40 percent of the issued capital of the company. It is pertinent to note that the percentage of public offer that was required to be offered for listing under the guidelines issued by the Ministry of Finance was as high as 60

percent of the issued capital of the company. Diminution in the percentage of public offer was permitted only in the case of foreign collaboration or joint sector enterprises. This was overnight brought to 25 percent in February 1993 by the Ministry of Finance at the insistence by the Securities and Exchange Board of India. Which in fact wanted it be 20 percent.

Share of Retail Individual Investors

The percentage reserved for retail individual investors (RIIs) should be raised from 35 percent to 50 percent of the public offer. Earlier under the guidelines issued by the Ministry of Finance, weightage was required to be offered on the entire quantum of public offer of 60 percent of the issued capital of the company to small investors, particularly those applying for 100-200 shares.

Safety Nets

To impart a degree of comfort to small investors, it is desirable to have safety nets for initial investors investing upto say Rs. 25,000 in new issues for a period of six months. Safety nets are in operation in some of the developing countries of the world.

SEBI guidelines in this behalf merely say that in case there is any safety net scheme or buy-back arrangement, it shall be limited up to a maximum of 1000 shares for original residents allottees valid for a period of at least of six months, thus making it optional.

Public Offer at Fixed Price

Fixation of price by the book – building process followed these days by almost all companies making public offers has been a matter of confusion for the small investors, particularly so because the bands are announced just a day or two in advance. Moreover, bands are charged occasionally. Investors in semi – urban and rural areas find it difficult to keep a track of all these. Moreover, ordinary investors do not understand terms like cut off price, options 1, 2 and 3, etc.

After all, book – building has not proved to be a good price discovery instrument in India, which is evident from the wide savings in prices generally noted on the first day of listing of IPOs.

A fixed price public offer reasonably priced keeping in view that the initial investors should reap some advantage can prove to be one of the biggest allurements to attract small investors into equities. There is nothing wrong if they turn out to be stags, as some other investors will come in their place.

Offer by PSUs only to RIIs

Profit-making Public Sector Undertakings disinvesting their shares need to be persuaded to offer the shares directly only to the RIIs so as to whet their appetite for

equities. Shares should be offered at a fixed price reasonably below the expected market price and allotments above Rs. 50,000 may be made only if the response upto Rs. 50,000 falls short of the offer. Leftists, who have been having their own reservation in this regard, will then soften their stand.

In case government chooses not to offer the shares to RILs only, then the portion of offer earmarked to the RILs may be made at a discount of at least 5 percent to the offer price to others. A similar approach was adopted by some of the PSUs like ONGC, GAIL, etc. in 2003.

Preferential Allotment

After the abolition of the Capital Issues Control Act, 1947, in May 1992, there was gross misuse of preferential allotments not only by MNCs but also by large domestic industrial houses. With a view to preventing the misuse, SEBI issued a guideline in August 1994, mandating the preferential offer to be at a price not less than the average of the weekly high and low of the closing prices during the preceding six months or during the preceding two weeks, whichever is higher. The misuse has, however, continued, particularly soon after bearish spells.

It is needless to say that preferential allotments militate against the interest of minority shareholders. It is, therefore, necessary to ensure that preferential allotments are made only in exceptional cases like allotments to foreign collaborations for exchange of technology, etc. and not otherwise.

Issue of Capital Abroad

It has become a fashion these days for companies to get their securities listed on foreign exchanges by issue of GDRs/ADRs. There is really no need for such issues to be made, particularly when the domestic market is in a bullish phase and the amount of capital offered to the public gets readily absorbed. This is evident from the fact that public offers of most of the issues get heavily subscribed, invariably resulting in allotments to RILs, particularly in lower categories not being firm but on a lot basis. This is because domestic household savings in the country are mounting while the public offers of capital are comparatively negligible. For example, domestic household savings in 2006-07 aggregate to about Rs. 9 lakh crores while capital raised during the year was about Rs. 35,000 crore i.e. just about 3.9 percent of the household savings; as compared to over 15 percent in several advanced countries.

While it may not be proper to prevent issue of capital abroad in the context of liberalization and globalization, companies must be required to offer adequate reasons to the regulator justifying such offer.

Issue of Indian Deposits Receipts

It is time foreign companies are allowed to tap the Indian market for meeting their capital requirements. SEBI has been making statements occasionally that guidelines for issue of Indian Deposits Receipts enabling foreign companies to raise capital from India would be issued.

India has at present a structure for raising fresh capital for more sophisticated than those in foreign countries, and a disclosure system on par with the foreign countries. While FIIIs are freely allowed to operate in the secondary market, both cash and derivatives, there is no reason why foreign companies are not allowed to tap the primary market, particularly in the context of surging domestic savings.

Regional Stock Exchanges for Spread of Equity Culture

20 Regional Stock Exchanges (RSEs) of the country have state-of-the-art technology for trading, clearing and settlement of securities, which are presently lying idle as there is practically no trading on any of them. The technology they have can fruitfully be utilized for marketing of primary issues, particularly in semi-urban and rural areas, which are virtually totally neglected. At present 15 major cities of the country collect about 95 percent of the subscriptions from public offers of capital.

The RSEs, besides National Stock Exchange and Bombay Stock Exchange, may be permitted to participate in the book-building process. At least two syndicate members may be appointed from each of the RSEs participating in the issue process. All willing trading members of participating stock exchanges may be allowed to tie up with the syndicate members as sub-syndicate members. The electronic clearing system of the stock exchanges can be used for transfer of subscription amounts from the investors to the syndicate members and from the syndicate members to the concerned lead managers.

Benefits of investments in equities which are reaped at present by the citizens of metropolitan cities and that too by the creamy layer, can then spread to semi-urban and rural areas and that in turn will help to widen the equity base in the country.

With practically no trading being at any of the RSEs, and the prospect of RSEs not being associated in the creation of a third trading platform for small and medium entrepreneurs and also RSEs being requested to disinvest their holdings in their subsidiaries to the extent of 85 percent, as per the recommendation of Ananthraman's committee report, on "The Future of Regional Stock Exchanges - Post Dematerialisation", future of all the 20 RSEs, including the Calcutta Stock Exchange, which used to have a turnover next only to that of BSE, is doubtful. Recognition granted to the RSEs under the Securities Contracts (Regulation) Act, 1956, irrespective of whether on a permanent basis or temporary basis, will have to be withdrawn as the Act is designed solely for the purpose of regulating business in securities and a stock exchange ceasing to have any dealings in securities can not continue to enjoy the status of a recognized stock exchange.

Discourage Delisting of Securities

Delisting of securities from stock exchanges by buy-back of securities has been progressively rising. This is being resorted to not only by MNCs but also by some of

the domestic large industrial houses. Norms relating to reverse book – building for determination of the buy-back prices are attempted to be diluted.

It is needless to say that delisting of securities by profit-making, dividend-paying companies militates against the spread of equity cult. One possible way of discouraging delisting of securities is to impose a rate of tax on unlisted companies at a rate higher than that on unlisted companies by say 10 percentage points. In fact, till March 1992, the rate of corporate tax on companies in which the public are substantially interested, which included listed companies, used to be five percentage points lower than that on companies in which the public are not substantially interested.

Compensate Investors of Vanishing Companies

The Ministry of Company Affairs has been resting contented with the prosecutions launched against promoters and directors of vanishing companies. Welcome as the move is, it offers no solace to the victims of these companies who need to be compensated for the losses they have incurred by subscribing to the shares of these companies.

The argument that investment in equities is a matter of risk and reward can not be extended to vanishing companies, as the promoters and directors of the companies and other related entities like merchant bankers and auditors can rightly be accused of having defrauded the public. All possible efforts should, therefore, be made to recover the monies from the personal assets of promoters and directors of these companies, besides the penal action that need to be taken against them. Penal action like fines, suspension, expulsion, etc. should also be taken against the merchant bankers and auditors. In the meantime, investors should be compensated, at least to the extent of Rs. 50,000 invested by them in the vanishing companies from the Investor Protection Funds of the concerned stock exchanges and of SEBI and also the Investor Education and Provident Fund set up under section 205C of The Companies Act, 1956 “ to be utilized for promotion of investors awareness and protection of interests of the investors.”

Uniform Face Value

Ordinary investors are baffled by the varying face values of shares, as it becomes difficult to calculate instantly the PE ratios and dividend yields. Guidelines issued by the Ministry of Finance in 1979 directing companies to convert the face values of shares to Rs. 100 or Rs. 10 were aimed at removing the confusion due to the different face values of shares of companies.

SEBI was advised that there should no face value and companies should speak only in terms of outstanding shares so that the shares represent the networth of the company, on line with the practice in several developed markets of the world. Instead of accepting this suggestion, which is better than having varying face values, SEBI permitted companies in 1998 to have any

face value of shares of their choice. As a result, not only companies issuing IPOs choose any face value that they think is proper but several existing companies also split the shares altering the face value of their choices.

In order to remove the confusion in the minds of ordinary investors, it is necessary to issue a directive to all listed companies to convert the face value of their shares to uniform face values of Re 1, Rs10, or Rs.100. Besides, companies should also be directed not to split the face value of shares unless be it that the price of the share exceeds Rs. 10,000. This will not hurt the interest of small investors as trading lots are at present one share or multiples thereof.

Illequid Shares

There are about 4,000 companies listed exclusively on regional stock exchanges whose shares are not traded at all, and another about 2,000 companies listed on Bombay Stock Exchange whose shares are also not traded at all. Investors in the shares of these companies have no exit route.

While all possible efforts need to be made to create a market for the shares of these companies by way of appointment of market – makers with liberal supply of stocks and funds, call action systems, etc. there will still be about 5,000 companies trading in the shares of which can not at all be revived. These shares should be bought over by the Asset Reconstruction Corporations (ARCs) at a nominal value of say one paise per share so that the holders of these shares can book losses. Under the Income Tax Act, losses cannot be booked unless there is a transfer. It is likely that ARCs may profit eventually by such purchases.

Regulation of Investment Advisors

Investment advisors have proliferated all over the country. All brokers and sub-brokers also act as investment advisors. There is no responsibility attached to them.

In most of the advanced countries, investment advisors are regulated. It is time, we also subject all investment advisors to registration by SEBI under the Securities and Exchange Board of India Act, 1992. Besides, no one should be allowed to act as an investment advisor unless he passes some certificate course duly approved by SEBI.

Abridged Prospectus

Abridged prospectus, called memorandum, are presently printed in bigger fonts, thanks to SEBI. Even so, perusal of the memorandum is a difficult proposition for an ordinary investor, printed as it is in a bigger format with no index.

In order to enable the ordinary investors to go through the memorandum with ease, it is necessary to print the same in the form of a booklet with a proper index, on the lines of offer documents of mutual funds. Application forms can also be printed with the same issue with instructions and attached to the memorandum.

Multiple Application

As per the present regulations, submission of multiple applications is not an offence. The only punitive provision is that they are liable to be rejected.

It is time that submission of multiple applications is made a criminal offence, punishable with fine and/or imprisonment. It is worth recalling that a Member of the British Parliament was sentenced to three months imprisonment for having submitted multiple applications against the public offer of shares by British Telecom in 1984.

Investor Awareness Programmes

Investor Awareness Programmes are no doubt being conducted at present by stock exchanges, depositories, investor associations, etc. These need to be intensified. Besides, booklets and pamphlets containing proper guidance for investment in securities, including dos and don'ts, risk and reward nature of investment in equities, demat facilities, etc. need to be printed and be made freely available to investors through the length and breadth of the country. The outfits of brokers, sub-brokers, investment consultants, depository participants, etc. should supply these booklets and pamphlets freely to investors. Stock exchanges should print the literature

and make the same available. The cost can be funded from the Investor Protection Funds of stock exchanges and SEBI, and also the Investor Education and Protection Fund of the Ministry of Company Affairs.

Conclusion

India is presently growing fast with its GDP rising annually by over 8%. Sadly the gap between the rich and poor is widening. Stock market instruments can be utilized to narrow down the gap, albeit marginally, by widening the base of investors in these instruments. This will be in time with the directive principles of the Constitution of India which, inter alia, ordains that "the ownership and control of the material resources of the community are so distributed as best to sub-serve the common good" and that "the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment"

Let all the concerned parties like government, SEBI, stock exchanges, stock brokers, sub-brokers, depository participants, etc. resolve to treble the number of individual shareholders in the country from about 15 million at present to 50 million in the next five years i.e., by 2012. Let the year 2008 be celebrated as Small Shareholders Year.
