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## Promoter vs small investor

Both CCI's total control on issues and unregulated allotment practices are investor unfriendly, says Uttam Gupta

**W**HEN the Indian companies went abroad with Euro-issues, they, were dazzled by the glitter of cheap money. The money enabled them to return high cost loans taken from Indian FIs, fund working capital requirements for a song and show substantially improved profitability.

But, there was a flipside. Because of the GDR issues, the foreign investors increased their share holding in the companies to a point whereby the promoters started feeling threatened, notwithstanding the majority share holding by Indian FIs whom the promoters perceived as unreliable in view of its role in some of the take-over bids.

To consolidate their position, the promoters have resorted to appropriation of shares/warrants to themselves on a preferential basis at prices substantially lower than the prevailing market prices. The phenomenon has embraced even companies which did not go in for Euro-issues and, consequently, face no threat.

Abolition of the institution of the CCI and free market pricing of the instruments has undoubtedly given encouragement to such tendencies. In companies where FIs do not have a dominant stake, adoption of a simple resolution at the AGM is enough to get the preferential allotment to the promoter. Earlier, in companies with multinational connections, the foreign partners have been allowed to get away with substantial increase in their share, taking advantage of the overall liberalised government policy towards foreign investment.

The authorities have woken up to these emerging trends belatedly. The RBI guidelines seeking to regulate preferential allotments to the foreign companies came only in April 1994, by which time the appropriations had already been carried through. The guidelines by FIs announced in July, 1994 to regulate allotments to Indian promoters generated more of confusion than providing an effective regulatory environment. The recently notified SEBI guidelines are undoubtedly far more comprehensive. However, it is doubtful whether this can be enforced. Legally, the promoters can still get away with what they do.

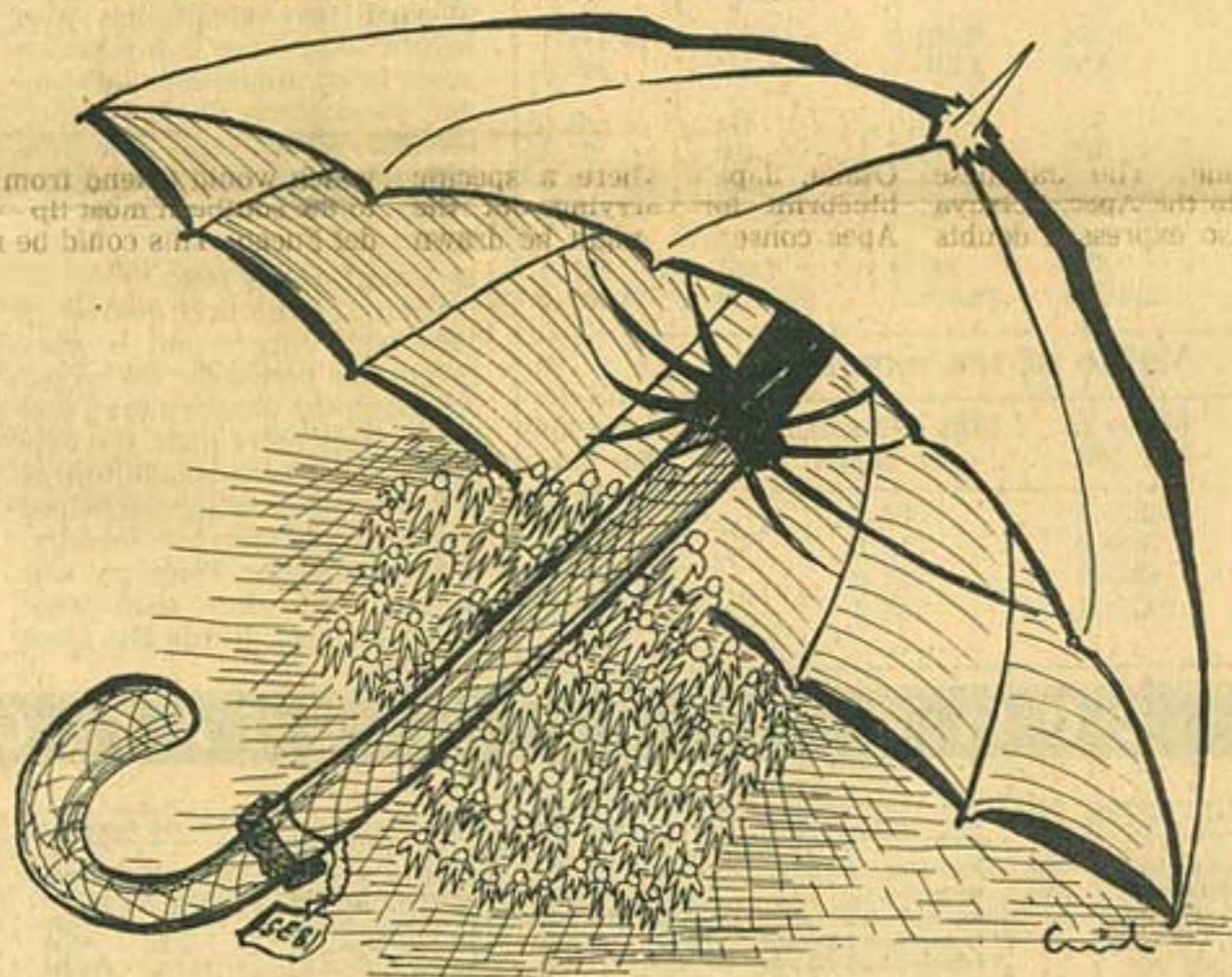
Even as the FIIs and the Indian promoters are shadow-boxing over

the ownership and management control, no one seems to be bothered about the ordinary investor. The latter gets affected in several ways. First, if he wishes to increase his holding or even subscribe to the share capital through a primary issue, he has either to pay the prevailing market price or shell out a hefty premium. Sometimes, even the rights issue to an existing shareholder is made available at a premium. In contrast, the promoters get away with increasing their stake by paying unrealistically low prices.

Second, on the expanded equity

unloading an attractive proposition. That would jeopardise stability and affect the working of the company, which may even turn sick.

Such instances are not found wanting whereby because of the promoter's misdoings, the companies are pushed to a point whereby even the FIs and the commercial banks are not able to retrieve their funds not to talk of the ordinary investor for whom his investment becomes a dead loss. The modus operandi of preferential allotment by facilitating easy access to ownership would only make matters even worse.



base, divisible profits would result in reduced dividend on each share. The argument that the company's profits too have increased and that the dividends declared in majority of the companies have been higher is misleading, as the improved financial results in the immediate past are primarily due to fortuitous gains in terms of interest savings or earnings caused by mobilisation of Euro-money and lower depreciation. It is doubtful whether the present high dividend levels can be maintained, particularly when the funds thus collected are not being deployed productively.

Third, for those who have acquired increased holding by not paying a commensurate price, the much higher prevailing market price always makes

The problem has to be addressed from the perspective of small investors who still constitute a significant holding besides the FIs. The regulatory arrangements must aim at protecting their investment in the company and ensuring a reasonable return to them on a regular and consistent basis.

As a first step, the SEBI guidelines should be made enforceable by law and extended to cover all past deals (for a year post notification) and future deals and the difference between the price actually paid and the six monthly average of the market price on a weekly basis recovered.

Unfortunately, this is not being done, particularly in respect of pre-May 4 deals. Moreover, none of the current deals (executed until 4th No-

vember, 1994) even at the market related price will be covered by the five year lock-in period. This approach is too liberal to the point of even negating the very objective for which the very guidelines were introduced.

Second, there is no reason why even ordinary shareholder should not be given the opportunity to bid and get a share on a pro rata basis for preferential allotment, so long as he is prepared to pay the envisaged price. Merely because the promoters have put in more money in the initial stages should not entitle them alone to a preferential treatment.

Consequent to the SEBI guidelines on preferential allotment, the promoter are now resorting to the stratagem of offering public issues at a premium but lower than the market price offering 25 per cent to the public and keeping 75 per cent for themselves on firm allotment basis. This is not only highly unfair but unethical too and contrary to the SEBI guidelines.

Thirdly, although such vital decisions are subject to approval by the AGM, the latter is virtually a show monopolised by the promoters. In matters of such extraordinary significance, it may be worthwhile to insist on a certain percentage of the shareholders sending their approval to the specific resolution by way of an endorsement or rejection on a reply form which can be sent along with the invitation letter for the AGM. This would give the preferential allotment a wider sanction and enhance the credibility of the decision.

There is need for making the FIs fully accountable to the responsibilities thrust on them by way of enormous amount of public money. The FIs must not only ensure safety and yield on the public funds channeled through them but also the investments directly made by the shareholders by way of equity.

In a short period, we have moved from the extreme of total control by the CCI on the issues by companies to one of free pricing and totally unregulated allotment practices. Both the extremes are investor unfriendly. The latter might have been a better option if only the capital market in India was fully matured, operations transparent and information system well developed. Unfortunately, these conditions are still woefully lacking. Hence the need for effective regulatory mechanism.