

## Improving common investor confidence in public issues of India

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### Abstract

This Initial Public Offering can be made through the fixed price method, book building method or a combination of both. The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued. "Issued" here means issued to the public. What does or does not amount to an issue is a question of fact in each case and is not capable of exact definition. In *Nash v Lynd* it was held that "the term 'issue' is not satisfied by a single private communication". The facts were that a document marked "strictly private and confidential" but in form a prospectus was prepared by the defendant, the managing director of a company. But the document did not contain all the material facts required by the Act to be disclosed.

**Keywords:** public offer, allotment, subscription, forfeiture

### Introduction

A listed Public Company may raise capital in the primary market by way of an initial public offer, rights issue or private placement<sup>[1]</sup>. An Initial Public Offer (IPO) is the selling of securities to the public in the primary market. This Initial Public Offering can be made through the fixed price method, book building method or a combination of both<sup>[2]</sup>. The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued. "Issued" here means issued to the public<sup>[3]</sup>. What does or does not amount to an issue is a question of fact in each case and is not capable of exact definition. In *Nash v Lynd*<sup>[4]</sup> it was held that "the term 'issue' is not satisfied by a single private communication". The facts were that a document marked "strictly private and confidential" but in form a prospectus was prepared by the defendant, the managing director of a company. But the document did not contain all the material facts required by the Act to be disclosed. A copy of it along with application forms was sent to a solicitor who in turn sent it to the plaintiff. The public issues were regulated and consequently even the issue price was to be fixed by the issuer within the formula provided therefore. Also, with a clear policy to spread equity-cult in the capital market, the policy then prevalent was encouraging allotment to the applicants of the lowest lot with the highest weightage and scaling down to the applicants of the highest quantity with almost the lowest weight age.

During this period, while the main objective of creating an equity-cult was accomplished, certain undesirable practices developed for want of technological support since the issue work and post issue work were involving huge amount of paper work, co-ordination, collation and dispatching. In this regard, the first step initiated by the Government was to repeal the Capital Control Issue Act<sup>[5]</sup> and made the total mechanism subject to regulations/disclosures as may be prescribed by the capital/securities market regulator (Securities and Exchange Board of India – 'SEBI') from time to time. Consequently, the issuers were allowed to raise money from the public by fulfilling the requirements as prescribed in the regulations/disclosures governing the public issues<sup>[6]</sup>.

While various reformative measures have been put in place to ensure proper and upfront disclosures through prescribing guidelines/norms or notifying the regulations therefore; like applications to contain brief prospectus<sup>[7]</sup>, issuers to fix the premium, IPO through book building process, allotment of securities in demat form only<sup>[8]</sup>, allotment of securities to be completed within 15 days from the day of closure of the issue and issue of refund orders or crediting the securities to the beneficiary accounts of the allottees within 15 days, requiring the issuer to pay interest to the applicants if there is delay in issuing refund orders beyond 15 days as indicated above, facilitating the allotment to the applicants on proportional basis,

<sup>1</sup> Companies Act 1956 in S.2(23-A), inserted by the Amendment of 2000.

<sup>2</sup> Sources: BSE India "About Public Issue"

<sup>3</sup> The Act says in s. 2(22) that "issued generally" means, in relation to a prospectus, issued to persons irrespective of their being existing members or debenture-holders of the body corporate to which the prospectus relates. Section 67 says that no offer or invitation shall be treated as made to the public if it is not calculated to become available to person other than addressees or is otherwise a domestic concern of the person making and receiving the offer etc. The Amendment of 2000 has restricted this number to 50 persons. The effect is that any circulation to more than 50 persons would become a public offer.

<sup>4</sup> 1929 AC 158 : 140 LT 146. see also *sherwell v combined incandescent mantles synd; cate Ltd*, (1970) 23 TLR 482; *baty v keswic*, (1901) 85 LT 18 : 17 LTR 664.

<sup>5</sup> the Capital Issues (Control) Act, 1947. Under the Act, the Controller of Capital Issues was set up which granted approval for issue of securities and also determined the amount, type and price of the issue. This Act was, however, repealed in 1992.

<sup>6</sup> Securities and Exchange Board of India (Buy Back of Securities) Regulations, 1998 Substituted for "the Companies (Amendment) Ordinance, 1998 (19 of 1998)" by the SEBI (Buy-back of Securities) (Amendment) Regulations, 1999 published in the Official Gazette of India dated 21.09.1999

<sup>7</sup> Companies Act 1956 in s.2(1), vide Amendment of 2000.

<sup>8</sup> The depositories act, 1996, vide Amendment of 2000, provides that every listed public Company making initial public offer of securities of Rs 10 crore or more shall issue dematerialised form.

reserving certain portion of the issue (25% to 35%) for the public applying for Rs.50000 or less, etc. In the last one year, about a dozen of public issues tapped the public through book building process as also through the normal process. It is observed that as the secondary market has been doing very well progressively since April 2003, even the primary market has shown very good response to the issues which was evident from the public issue of Maruti emanating out of the Government decision of divestment. In this regard, there are a few points deserving attention from the policy perspective so that the underlying objective of the Government and the Regulator of sharing the benefits of the economic growth with the investing public could be effectively accomplished.

**They are**

#### **1. Review of Minimum Allotment of 100 shares:**

While the scheme relating to public issue for the purpose of inviting applications may continue to prescribe minimum lot of 100 for the purpose of making applications, since the trading lot in the electronic trading environment has been reduced to 1 (which has been consciously reduced to facilitate easy and larger participation), it is imperative to review this aspect of minimum allotment<sup>[9]</sup> of securities wherever the public issue is oversubscribed. It is suggested to prescribe the minimum allotment size of 10 and multiple of 10, wherever the issue is over-subscribed<sup>[10]</sup>. This will reduce the gap for participation in the secondary market and the primary market as in the secondary market one can acquire one share while in the primary market, one will get allotment of 100 shares or else the refund.

#### **2. Minimum issue of 35% for public subscription**

In an offering made through book building process, minimum 50% is for QIB and remaining 50% between retail investors 25% and other than retail investors 25%. As SEBI has now decided to raise minimum public holding as 25% as a continuing listing requirement, it is necessary to fine tune the requirement for IPOs through book building process and through fixed price determined through book building process by raising 25% kept for retail investors to 35%, 15% for other than retail investors and the remaining 50% for QIBs. Such a change would not only bring in added life into the public issues but would also help in broad basing the equity dispersal.

#### **3. Broad basing of investors**

Upon bringing down the minimum allotment size to 10 shares, in respect of any security, there will be relatively larger base of investors as where the public issue is oversubscribed by more than 10 times, there will be 10 times larger number of allottees. This will serve the

objective of facilitating them to reap the benefits of the economic growth and thus making the capital market vibrant, much needed by any nation thriving for faster and accelerated growth of economy.

#### **4. Addressing surveillance concerns**

As the proportionate allotment facilitates larger allotment to applicants applying for large quantity of shares, the above proposition would ensure that allotment would not be concentrated in restricted number of allottees but upon allotment, there would be large number of allottees/investors. Such a change in policy of allotment may in an indirect manner mitigate/address the issue relating to surveillance, to an extent, more particularly about the undesirable practices like manipulation in price or volume, as the interest in the security would then be quite well-spread among broad based investors.

#### **5. Prescribing trading lot as 10**

Minimum trading lot of 1 has facilitated participation by any investor for any high value security. It also provides an avenue many a time to use this facility for purposes other than the intended ones like gradually and progressively taking the prices up with one trade of one share or using this facility for reference price. Therefore, to check such undesirable practices, it is imperative to consider prescribing a trading lot of 10 for the purpose of trading for the securities getting listed on the stock exchanges for the first time and after reviewing its impact, considering appropriate measure in relation to the securities already listed and traded.

#### **6. Refund orders through ECS**

Many processes have been streamlined over a period of time with a view to bring in efficiency in the management of post issue related work. Like, in a book building issue, the securities are getting directly credited to the beneficiary account of the allottees, wherever the applicants are having bank accounts with the banks offering ECS facility, why should the refund amount not be directly credited to the accounts of those applicants/allottees and only the intimation/advice given by post. This will not only reduce the cost of posting the refund orders through registered post but also adds to the efficiency in the total post public issue process.

Considering phenomenal growth of technology in the banking industry, most private sector banks offering anywhere banking and electronic facilities as well as those public sector banks which also offer like facilities would be able to offer this facility. Further, even RBI is contemplating to put in place the RTGS initially for limited number of locations and thereafter on a fullfledged basis nationwide. Therefore, it becomes necessary for the regulator to review this aspect and consider making it mandatory to credit the refund amount to the bank accounts specified in the applications through ECS except where the banks (co-operative) do not have such facility or do not extend such facility at certain locations. In such cases only the refund orders need to be allowed to be sent by registered post as applicable now.

<sup>9</sup>Allotment is generally neither more nor less than the acceptance by the company of the offer to take shares' CHITTY J in Florence Land & Public Works Ltd, Re, (1885) 29 Ch D 421, 426, adopted by the Supreme Court in Sri Gopal Jalan & Co v Calcutta stock Exchange Assn, AIR 1964 sc250:33Comp Cas 862.

<sup>10</sup> Companies Act 1956 in s.73(2-A), The prospectus being over-subscribed, the over-subscribed portion of the money received must be sent back of the applicants forthwith.

### 7. Standardization of Face Value to Rs.1 or Rs.10:

SEBI has rightly given freedom to the issuers to fix the face value of a security to be traded in equity segment of a stock exchange<sup>[11]</sup>. It has served the purpose of making various securities available to the common investors. At the same time, this facility has created issues in the nature of having different denominations of face value for equity shares which many a time do not give correct perspective about the valuation of the security and as such misleads about the market price unless one is keeping very close look and control on such aspects. It is therefore necessary to have uniform set of denominations (say Rs.1 or Rs.10), to be applied in accordance with the formula prescribed by SEBI for the purpose of going in for a split and/or consolidation, which should be available for use by the issuers. This type of discipline would be akin to the discipline existed prior to repeal of the CCI Act where the Government gave direction to the stock exchanges to have equity shares of Rs.10 only and wherever any other denomination was used, provided time frame to the issuers to convert their equity shares into Rs.10. The above measures are essentially aimed at adding to the efficiency in the total post issue process and making the process much more investor-friendly which would ensure increased level of participation and interest by spreading the equity-cult and facilitating reaping of the benefits of the economic growth by the investing public; most cherished objectives of the Government, Regulator, Stock Exchanges and the Issuers.

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<sup>11</sup> The Ministry of Finance, vide circular no. 1/7/SE/81 dated January 22, 1983, had stipulated that equity shares which are in denominations other than those of Rs. 10/- or Rs. 100/- should be converted into those of Rs.10/- or Rs.100/- before December 31, 1983.