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AGENDA

Killing the goose that lays golden eggs

The slump in the stock markets clearly reflects the investors' total loss of confidence. The fault lies squarely with the corporate world. Instead of cultivating the trust of investors through credible commitments and commensurate performance, promoters sought to make a killing at the expense of the investing public. This mindset must change if things are to improve, says Uttam Gupta.

ON the last day of trading at the Bombay Stock Exchange in 1995, over 1700 of the 5200 stocks listed were quoting below their face value. The discount was as much as Rs 3-4 in majority of the cases. This means that should the holders of these shares decide to sell them in the market, they will be doing so at a substantial loss.

It is also unlikely that for the period that the investor has been holding on to the stock since he purchased, he would have earned any dividend income. A promoter who on the strength of his company's fundamentals, cannot ensure buying interest in the stock, how can one expect him to pay dividend?

It may be argued that his stock was getting affected by overall recessionary trends in the capital market. However, this arguement cannot sustain especially when we consider that the balance 2/3rd of the scrips are quoting above par value. Clearly, most of the companies quoting at discount are the ones with weak fundamental. Some of them may even be dead wood.

Leaving aside dead wood for the time being, even in respect of the balance quoting below face value, there is a great deal of uncertainty about the future. The investor is not sure whether the bottom has already reached from where the price can only increase, or it may even go down further. In the latter possibility, the potential loss could be even greater.

Herein, we need to recognise that the market works on psychology. If an expectation builds up that the prices will move downward, there could be selling pressure which may bring about a precipitous fall. The speculators who rule the roost in most of the stock exchanges and may even be in the know of sensitive information (not excluding contemplated policy changes), are capable of exacerbating such trends. For instance, they can engineer the fall up to a point at which they can buy the stock and make a killing at the cost of the ordinary investors.

Ironically, such activities of the speculators have even received support from the commercial banks/financial institutions. Institutional financing of stock market transactions has been rampant. Some time back, the RBI even allowed commercial banks to invest in shares in the secondary market thus leading to more direct involvement.

Until the M S Shoes fiasco and the devolvement of a number of other issues like Malvika Steels and Bhushan Steels came to limelight, even the bridge loan (a project implementation), was being extensively used for buying companies own share and price rigging. Although, the RBI was reported to have withdrawn this facility, subsequently, this was permitted in certain cases subject to prescribed conditions.

So much so, the government has even permitted use of the GDR proceeds for propping up the capital market despite the fact that these funds are meant for utilisation in projects, including expansion and modernisation of existing units.

Not long ago, we have seen the unusual phenomenon of the the unmindful investing community overwhelmingly subscribing to primary issues and rights issues at hefty premiums and losing heavily with share prices tumbling much below the purchase price. Some of us may tend to dismiss this as pure market behaviour and even put the onus of loss on the investors themselves, that the investing community worked merely on impression not caring to check even the basics about the promoters, their track record, etc before deciding to invest. Consequently, they have paid a price for their own negligence.

It would, however, be unfair to ignore the role of the promoters and underwriters, who have collaborated in a neatly orchestrated gameplan to benefit at the expense of the hapless investor. While all this went on, the regulatory authority (Sebi) has looked on as a mute spectator. All that it has done in the event of the malpractices being noticed is to order the suspension of trading in the concerned scrip. It goes without saying that this step too harms the ordinary investor as he loses the chance of even realising whatever limited worth the share has.

Having burnt their fingers on premium issues, the investors have now become extremely discerning. Not only that the investors say a categorical 'NO' to a premium issue, they are also selective in subscribing to issues at par.

Under these circumstances, if the capital market has completely dried up leading to undersubscription of issues of a company with sound economic fundamentals and that too at par, it should not surprise anyone.

There was a time (1993-94 and first half of 1994-95) when body corporates were getting funds from the capital market for a song. They were no longer taking loans from the banks/FIs, on the contrary, some of them even returned the loans. Now the situation has taken a U-turn.

Unable to raise funds from the capital market, the corporates are now rushing to the banks/FIs to meet their needs. The latter are already heavily short of funds partly due to deposits not growing at the desired pace, but, mainly because of the government's heavy borrowings spree. This has caught the industry in a bind even as it cries hoarse about a serious liquidity crisis.

Clearly, there is a total loss of investors' confidence. And, the onus for this lies squarely on the corporate world. Instead of cultivating trust with investors through credible commitments and commensurate performances, the promoters treated the investing public as a goose that lays golden eggs and sought to grab as much eggs as possible at one go.

> **Until the M S Shoes fiasco and devolvement of issues like Malvika Steels and Bhushan Steels came to light, even bridge loans were being extensively used by companies to buy their own shares and to rig prices.**

The government too allowed this mindset to flourish even as it set its eyes on financing of massive resource requirements for development entirely through the capital market. This mindset must change if things are to improve.

The promoters and the brokers alike have blamed the lack of liquidity and the ban on the carry forward system as the causative factors behind the recession in the market. The mandarins in the finance ministry even sought to link it to the ban on bringing proceeds of euro issues.

Relaxations on these fronts may provide temporary push. However, the fact remains that unless the fundamental issue of lack of confidence is addressed, revival of the market and sustaining it is impossible. It is important to recognise that the announcement of the carry forward system failed to enthuse the market and it is unlikely that its recent implementation will improve the situation.

Already, the volumes have come down drastically. Although, in the long run the brokers feel optimistic, the expected buoyancy cannot be sustained unless there is widespread investors' interest and concomitant infusion of funds from the public.

To improve the situation, the Sebi should play a proactive role. Foremost, it should make sure that only serious and established promoters with good track record and having viable projects are allowed to enter the fray.

Second, there is need for greater accountability of the underwriters. Presently, if the issue flops leading to devolvement on the underwriters, the latter are allowed to go scot free. Not only this, the underwriters pick up shares on private placement basis, boosting the market sentiment and offload at the resultant higher market price. Thereafter, it is the innocent public that is saddled with dead weight. The underwriters should be compulsorily made to keep the shares with them for a minimum period of time.

Third, there is a need to improve the quality of various disclosures. The present pattern of projections while prominently highlighting the areas of strengths, fail to adequately highlight the weak points. For instance, in various displays, the risk factors cannot even be read. Why not adopt telegraphic and crisp language to project these as is done for showing the P/E ratios, etc?

Fourth, the system of depository and screen-based trading and settlements will help in achieving increased transparency and reducing the scope of various malpractices — insider trading and price rigging. Although, various stock exchanges are supposed to be working on it, progress on this front is unpardonably slow.

Finally, to the extent possible, the government should try to minimise the uncertainty of policy in key areas and refrain from interventions on impulses. This will help in bringing the stock market trend closer to the fundamentals of body corporates and also help in eliminating non-serious players.