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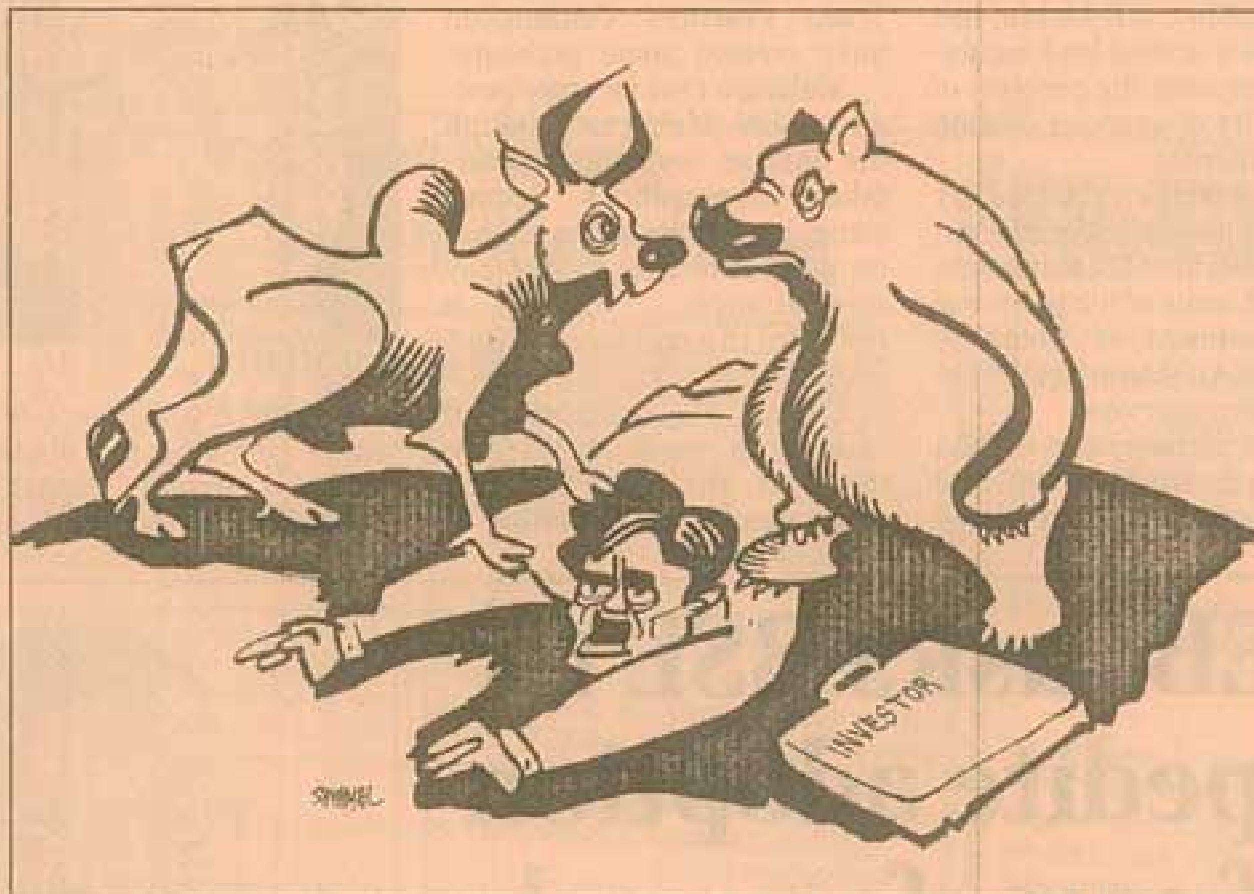
COMMENT

Prospectus is not gospel truth

Uttam Gupta demands a fair deal for investors, against the current dispensation that only takes them for a ride



OF the 900 companies or so, which hit the capital market during April 1994 to January 1995 with public issues, over 300 are trading at a discount or around their offer price. The immediate implication is that, in case the shareholder decides to sell the shares in the secondary market, his realisation will be less than the money he had invested. Initially, when he paid a hefty premium for subscribing to the issue, he did so in the expectation that the share will appreciate in value giving him a significant benefit by way of capital gains. Far from that, he suffers a loss because the share is actually quoting at a discount.

The other attraction when he decided to invest, was easy liquidity, i.e. the possibility of converting the share into ready cash. On this score also, his expectation has been belied as in the overall depressed market conditions, it is unlikely that he would get a buyer. Even when the market revives, which possibility looks remote right now, the chances that he would be able to sell while fully covering the amount that he initially paid, look remote and, all the more so, for a company that came with a hefty premium.

It must be recognised that there have been umpteen cases of the share price having been rigged at the time of listing, very often, with funds borrowed from the banks/FIs. That being the case, it is almost inevitable that after the issue is subscribed, the share will trade at a discount and it is unlikely that, over a period of time, it would return to the level of issue price. This is because the premium amount, in the very first instance, was not linked to the economic fundamentals of the promoter company. In such cases, the investors will be saddled with an almost permanent loss.

In regard to the dividend, if it is a company which disappears into oblivion either immediately or some time thereafter (such cases are indeed quite large), the question of a dividend income does not arise. Even if it is the case of a dividend-paying company with a good track record, the investor is perpetually at a disadvantage. Consider, for instance, a share with the par value of Rs 10 for which he pays a premium of Rs 90. If the company is using the funds for a new project, it may not pay any dividend for a couple of years until such time the project is commissioned and gets into commercial production. Thereafter, and even assuming that the company pays a fairly attractive dividend of about 30 per cent, what the shareholder gets in his hands is only Rs 3 on each share. On his investment (which includes the premium amount of Rs 90), however, i.e. Rs 100, the return is a measly three per cent. Even in extraordinary cases, where the company may be paying 50 per cent dividend, the effective return to the shareholder is just about five per cent.

It might be argued that the promoters too get paid on the same basis in respect of their equity contribution. So, where is the question of the ordinary investor having been discriminated against? On this, two important points need to be considered. First, most of the promoters have managed to appropriate shares to themselves at substantial discounts to the market/issue price with the result that the effective return to them is substantially higher than to the ordinary shareholder. Second, by virtue of having complete management control, they have full control over the manner of utilisation of the reserves (including the premium money) which can be deployed in furtherance of their financial interests. This is all the more significant in view of the same promoter having a substantial equity stake in several other companies which stand to benefit enormously from deployment of these surplus reserves.

Investors who have bought shares/units at the par value too do not have much to cheer about. Consider, for instance, the unit holders of Master Gain 92. During the last three years, they have not been paid any dividend and there is no appreciation in the value of the unit either. On the contrary, the market price of the units is even less than Rs 10. That apart, even if the holder wished to realise cash by selling at a discount, that too is not feasible thanks to the monumental problems of bad deliveries and a number of fake unit certificates doing the round. The disappointment in respect of other investments at par including in private sector mutual funds is no less.

Some really harsh steps are called for if the Government is genuinely interested in promoting the interests of shareholders particularly the small investors. First, SEBI should immediately put an end to the present indiscriminate practice of allowing primary issues at a premium to all and sundry. A premium issue should be permitted "selectively" based on clearly laid down criteria/guidelines which should be made transparent and open to public. Why not SEBI arrange for ads on TV and maybe even a discussion on an issue which is being considered for a premium? The investing public has a right to get the full picture particularly when it is being lured to shell out money several times more than the ownership entitlement.

> *Instead of being a mere fence-sitter, SEBI should involve itself proactively in protecting investors*

Second, the premium amount should be fixed in a reasonable, balanced and conscientious manner and must necessarily be related to the fundamentals of the promoter. The present practice of determining the premium amount on the basis of the prevailing market price alone should end. This is all the more so when price rigging is rampant and markets are far from being competitive.

An independent verification of disclosures made by the promoter is absolutely necessary. This will help in preventing fiascos *a la* MS Shoes wherein the net worth of the promoter is nowhere when compared to the massive funds mobilisation that he contemplates and easily gets away under the existing dispensation.

Third, transparency in market operations is an absolute necessity. We cannot afford to wait for the passage of legislation on the National Depository and introduction of screen-based trading. True, malpractices like price rigging and insider trading can be fully eliminated only when the screen-based trading is firmly in place. Until such time, however, the least the regulatory institutions can do is to carefully watch the critical moments at the time of issue hitting the market—the kind of buyers and sellers who are active, the track record of the brokers and more importantly, their source of funding and initiate appropriate corrective action on that basis.

Banning of bridge finance immediately after the MS Shoes fiasco was a good decision; its revival in the name of helping genuine cases is unfortunate. Before doing that, RBI should have addressed some hard-core facts. How many companies use bridge loans for meeting project needs? It is certain that funds will be used for this purpose, why should the promoter not first spend his contribution towards the project cost? This will not only demonstrate his sincerity and commitment to the project, but also keep the investing public in safe hands.

In the present dispensation, far from this, the promoter takes risk and even gambles with public money even as the regulatory institutions abet and encourage such tendencies by taking the words printed on that nice document, the "prospectus", as gospel truth. Not just that. In the event of being caught napping they seek protection or perhaps, absolute immunity for themselves rather than even attempting to reform the system.

Fourthly, SEBI should involve itself proactively in protecting investors instead of being a mere fence-sitter. It should shed its present procedure/rule-bound bureaucratic approach in favour of a professional body that focusses more on intelligence gathering, quick analysis, effective coordination and prompt action. Staffing and manpower should not be a constraint. Considering the magnitude of the work and responsibilities involved, the astronomical levels of market capitalisation, a bit of extra money spent on manpower would more than pay for itself by safeguarding the money of millions of investors, government-owned commercial banks and the financial institutions.

These measures will bring the capital market and issue prices close to the fundamentals, free them from the menace of unhealthy practices and yield the much-needed relief to the investing public. To a considerable extent, this would also reduce the problem of low dividend yield. However, in respect of premium issues, there may still be merit in linking the dividend pay-out to the value of funds actually invested by shareholders.

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