



Minimum Public Shareholding:

Norm Needs Fine Tuning

The proposal to raise the public float of listed companies would benefit the retail investors, but it needs to be finely tuned to ensure that the basic objective of the norm is achieved, says Rajesh Relan

The budget speech of the finance minister on 6th July 2009 has once again fuelled the debate on the issue of minimum public shareholding in listed companies. The Finance Minister has proposed to raise the public float in listed companies in a phased manner to check the price manipulations. He has said that the new norm would be uniformly applied to the private as well as public sector companies. Thus indirectly he hinted at disinvestment since change in the regulations would automatically compel the government to offload its stake in PSUs. However the stock market initially failed to notice this move and plummeted by around 5% on the budget day itself.

Public shareholding in a listed company means aggregate shareholding of retail investors, financial institutions, banks, mutual funds, foreign institutional investors, body corporates and NRIs and OCBs. The present regulations prescribe different levels of public shareholding for different companies. Some blue chip companies in the public sector with very high promoter (i.e. government) shareholding include Hindustan Copper (99.59%), MMTC (99.33%), NMDC (98.38%), National Fertilizer (97.64%), Neyveli Lignite (93.56%), ITI (92.98%), NTPC (89.50%), Power Grid (86.36%), SAIL (85.82%), REC (81.82%) and IOC (78.92%), while some of the private sector companies with very high promoter stakes are Reliance Power

(84.78%), UTV Software (83.25%), Tech Mahindra (83.23%), Mundra Port (81.04%), Wipro (80.53%), Jet Airways (80%), Godrej Industries (78.90%), DLF (78.65%) and TCS (75.09%)

Since the definition of public shareholding includes the shares held by all the non-promoter entities, the shareholding of the retail investors in most of these companies is miniscule. So, let's take a look at the concept and significance of minimum public shareholding and the likely impact of the proposed norm on the stock market.

Listing Requirements

Now a question arises as to how these companies managed to get their shares listed at the stock exchanges with so little public shareholding. The answer lies in Rule 19(2)(b) of the Securities Contract Regulation Rules, 1957 which provides that a company must offer at least 25 per cent shares to the public for getting listed. However the aforesaid rule was relaxed by SEBI in the year 1999 to enable the companies in information technology sector to come with IPOs with only 10 per cent public float. The justification given by SEBI was that neither the Indian market had the appetite for so many large IPOs nor did the companies need so much of funds. The rule was further relaxed in April 2000 to accommodate media and telecom companies. The said rule was once again amended by SEBI in the year 2001

to provide that all the companies proposing to issue at least 20 lakh shares aggregating to Rs 100 crore or more through book building could list with 10 per cent public float.

Another factor that can lead to high promoter shareholding in certain cases is amalgamation of unlisted companies of promoter group with the listed companies. It may be noted here that Regulation 3(1)(j)(ii) of SEBI Takeover Regulations, 1997, exempts the Scheme of Amalgamations from the applicability of the takeover regulations. Thus, promoters are free to increase their shareholding beyond 75 per cent by adopting this route. For example, promoters shareholding in Ramsarup Industries has increased from 66.79 per cent to 83.43 per cent, thanks to amalgamation of a group company namely Ramsarup Lohh Udyog Ltd.

Further clause 40A of the listing agreement provides that a company shall maintain on a continuous basis at least 25 per cent public shareholding. However, a company can continue to be listed with only 10 per cent public float if the original offer to the public was only 10 per cent of total capital; or the number of listed shares are more than two crores and the market capitalization is more than Rs 1000 crore. However, government companies, infrastructure companies and the companies referred to BIFR are exempt from this clause. That is the reason why so many PSUs are listed with less than 10 per cent public float.

Advantages of large public float

Large public shareholding is advantageous from the point of view of investors since it reduces volatility, improves liquidity, increases floating stock, prevents market manipulation, facilitates greater investor participation and wealth creation. Last, but not the least, it helps in proper price discovery. For example, MMTC whose share capital is Rs 50 crore and public float is just 0.67 per cent quotes at Rs 28,730, i.e. at P/E multiple of 939. Whether MMTC would be able to command such exorbitant valuation even after 25 per cent public float, is a million dollar question.

Every coin has two sides. While the proposed norm would be advantageous to the investors but the same would not be in the interest of the promoters since they would have to take effective steps to dilute their shareholding, albeit in percentage terms, within the prescribed time.

Ways to increase public shareholding

The public shareholding can be increased through combination of any of the following ways :-

- Follow-on public offer or Public Issue of shares.
- Private placement with Qualified Institutional Buyers (QIBs).
- Offer for sale to public by the promoters.
- Sale of shares by promoters in the stock market.
- ESOPs to employees.

Impact of proposed norm

The proposed norm can impact the stock market in manifold ways.

- The primary market would be flooded with public issues, which may reduce liquidity in the system.
- The companies would have to price their issues at considerable discount to the market price to attract investors in fiercely competitive primary market.
- The companies would be compelled to float public issues, irrespective of the fact whether they require funds or not. Hence, increase in number of shares coupled with the under utilization of funds raised would lead to decline in EPS and conse-

quently the share price.

- Public float in some of the listed PSU stocks like MMTC would rise manifold, resulting in sharp correction in share price. This would erode their market capitalization, causing loss to the government and the present investors who bought the shares at exorbitant prices.
- In case the promoters don't wish to come out with public issue they would have to sell their shares in the stock market at whatever price the stock could fetch.
- The promoters may consider increasing their shareholding beyond 90 per cent and apply for voluntary delisting of shares, which would defeat the very purpose of the proposed norms.

Will the norm achieve its objective?

The basic objective of the proposed norm is to increase the market depth and thereby prevent market manipulation. The move of finance minister is laudable but having the uniform threshold limit of 25 per cent for all the companies irrespective of their size, may not serve the purpose. This is because in case of small companies, even 25 per cent public float may not be adequate to prevent price manipulation, whereas in case of large cap companies, even five per cent free float may make it impossible for the market operators to manipulate the share price. Therefore, it is suggested that the government should not only give time of two to three years to companies to increase the public float but also the minimum public shareholding should be prescribed in the form of slab structure based on the company's share capital. The various slabs could be as follows:-

Issued Equity Share Capital	Minimum Public Shareholding (%)
Less than Rs 100 cr.	25
Rs 100 crore to Rs 500 cr.	20
Rs 500 crore to Rs 2,000 cr.	15
Rs 2,000 crore and above	10

Not only this, there is need to scrap clause 40A(iii) of the listing agreement also, which provides that companies having market capitalization of more

Shareholding pattern of Nifty companies as on 30/6/09

Company Name	Promoters	Institutions	Others	Public
ABB	52.11	33.92	2.71	11.26
ACC	46.21	31.88	6.17	15.75
Ambuja Cements	46.46	38.67	5.29	9.38
Axis Bank	42.22	36.05	16.89	4.84
Bharat Heavy Electricals	67.72	26.23	4.26	1.79
Bharat Petroleum Corp.	54.93	28.42	13.61	3.04
Bharti Airtel	67.41	27.47	3.90	1.22
Cairn India	64.68	17.38	15.57	2.37
Cipla	39.38	31.91	7.09	21.62
DLF	78.65	15.98	1.74	3.63
GAIL (India)	57.34	30.82	9.44	2.39
Grasim Industries	25.19	43.65	19.30	11.86
HCL Technologies	68.15	22.75	4.89	4.20
HDFC Bank	0.00	87.70	2.25	10.05
Hero Honda Motors	19.34	40.79	29.12	10.75
Hindalco Industries	54.96	36.76	1.18	7.10
Hindustan Unilever	36.10	32.84	19.97	11.09
HDFC	52.04	29.27	3.23	15.45
ICICI Bank	0.00	59.80	33.60	6.59
Idea Cellular	49.13	15.86	32.07	2.94
Infosys Technologies	16.49	43.95	23.58	15.99
ITC	0.00	51.00	37.19	11.81
Jindal Steel & Power	58.74	25.06	7.27	8.92
Larsen & Toubro	0.00	52.26	23.28	24.46
Mahindra & Mahindra	28.96	49.08	12.79	9.17
Maruti Suzuki India	54.21	39.31	4.50	1.98
National Aluminium Co.	87.15	9.38	2.78	0.69
NTPC	89.50	7.15	1.18	2.17
Oil & Natural Gas Corp.	74.14	12.36	11.80	1.70
Power Grid Corp. of India	86.36	6.80	1.72	5.12
Punjab National Bank	57.80	36.66	1.19	4.36
Ranbaxy Laboratories	63.92	16.55	5.90	13.62
Reliance Capital	53.49	26.69	5.50	14.33
Reliance Communications	49.03	25.58	14.68	10.70
Reliance Industries	37.75	45.02	4.67	12.57
Reliance Infrastructure	84.78	5.70	1.92	7.60
Reliance Power	67.26	18.52	4.25	9.97
Siemens	59.41	24.68	9.54	6.36
State Bank of India	55.18	25.39	2.90	16.54
Steel Authority of India	85.82	11.45	0.70	2.03
Sterite Industries (India)	61.71	17.78	16.63	3.88
Sun Pharmaceutical Ind.	63.71	23.90	6.61	5.77
Suzlon Energy	59.82	22.52	5.95	11.72
Tata Communications	76.15	12.81	9.08	1.96
Tata Consultancy Services	75.09	18.74	0.87	5.30
Tata Motors	41.38	26.58	21.35	10.69
Tata Power Company	33.17	48.28	1.11	17.44
Tata Steel	33.95	37.99	4.24	23.82
Unitech	51.23	27.61	9.72	11.44
Wipro	79.22	8.45	6.33	6.00

than Rs 1000 crore can continue to be listed with just 10 per cent public float. This is because the market cap keeps on fluctuating every day. For example, the market cap of some real estate companies has shrunk from over Rs 2000 crore in 2007 to less than Rs 500 crore today. Thus, if the government wants a permanent solution to this problem it must abolish the concept of public shareholding based on market cap.

To conclude, we can say that the proposed norm is like a bitter pill which may not be liked by the market initially, but it is essential for its long term health.

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