

Current Topic

Stop MNCs from deserting Stock Market

Indian subsidiaries of Several Multinational Companies (MNCs) are listed on various stock exchanges in the country and their shares are hot favourites with investors. Taking advantage of the current low phase of the capital market in India, several MNCs are coming out with open offers to buy the shares of their subsidiaries. The idea is to acquire the entire shareholding of the Indian public and thereby to turn their subsidiaries into wholly-owned subsidiaries and get them delisted from the stock exchanges and set themselves free from the necessity of complying with numerous irksome requirements of law. The open offers of buying the

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shares of their subsidiaries are, of course being made by them within the Takeover Code of the SEBI.

In this article, the author discusses this issue and points out that the strategy being adopted by MNCs, resulting in their desertion of stock exchanges, is disadvantageous to Indian shareholders and is not good for the economy of the country and that the SEBI should take urgent remedial measures - EDITOR

Introduction

1. In India there is a craze for shares of Multi National Companies (MNCs) and the Initial Public Offerings (IPOs) of Indian subsidiaries of MNCs are heavily oversubscribed. However, recently there has been a complete trend-reversal and instead of public or rights issue of shares, parent companies of MNC subsidiaries listed in India are coming out with open offers, so as to acquire the entire shareholding of the Indian public. Such open offers are being made for the purpose of converting the subsidiary into a wholly-owned subsidiary and getting its shares delisted from the stock exchanges. During the last one-year, parents of a number of MNC subsidiaries have come out with such open offers. Some of these companies are Philips, Carrier Aircon, Otis Elevator, Castrol India, Sandvik Asia, ITW Signode, Wartsila India, Thomas Cook, MICO, Cabot India, Foseco India, Cadbury and Reckitt Benckiser. Almost all the names listed above are hot favourite stocks of the bourses and it is very disappointing that the names of these companies will very soon disappear from the stock market quotations.

Reasons behind such offers

2. The reason behind the sudden spurt in open offers is that the stock market is depressed and the parents of these companies want to encash this opportunity by increasing their stake at a low cost. This is because as per Regulation 20(2)(d) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 1997, an open offer can be made at a price that is equal to the average of the weekly high and low of the closing prices of shares during the twenty-six weeks preceding the date of public announcement or a price higher than that.

All of us know that companies basically issue shares to the public and get themselves listed on the stock exchanges to raise funds for their projects or to finance their working capital requirements. However, this was not the case with subsidiaries of MNCs listed in India, as the primary reason for their listing was to ensure compliance with the provisions of the Foreign Exchange Regulation Act, 1973, which compelled the parent companies to reduce their equity shareholding to 4% within the stipulated period. In other words, for subsidiaries of MNCs, listing in India was more of a compulsion than a benefit. Therefore, in the year 1991 when the economy was liberalised, parent companies of almost all these MNC subsidiaries opted to increase their stake to 51% from the erstwhile limit of 40%.

2.1 Last year, the SEBI instructed stock exchanges to substitute the then existing clause 40A of the listing agreement with a new clause. The substituted clause, *inter alia*, required all the listed companies to ensure that they had at least 10 per cent non-promoter shareholding as on 1-4-2001. In case of non-promoter shareholding being less than 10 per cent companies were under an obligation to raise the same to at least 10 per cent, within a year. The clause further provides that in case a company fails to achieve this within the stipulated time period, an offer will have to be made for buy-back of the public shareholding in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997. Thus, as per the present norms, shares can be delisted from stock exchanges, if the promoters' holding after the open offer, is more than 90 per cent of the total paid-up equity share capital of the company.

Benefits to parent companies

3. One major factor that is inducing MNCs to delist their subsidiaries from the Indian stock market is that the SEBI is making the listing requirements and related disclosures stringent every year by adding new clauses to the listing agreement. Thus, MNCs look at delisting as an easy way of getting rid of various compliances required to be ensured by their Indian subsidiaries listed in India. Moreover, listing in a number of countries adds to the problem of MNCs as they have to comply with different sets of listing requirements that are unique to each country. Some companies also feel that listing forces them to share a lot of information with the public in the wake of corporate governance due to which confidentiality cannot be maintained.

Loss to Indian shareholders

4. Delisting of MNCs from stock exchanges in the aforesaid manner is against the interest of investors, and it is indeed not good for the stock markets. It will have an adverse effect on our economy as a whole. This is because if all the major MNCs, like the ones named above, desert our stock market then what will be left for trading will be a handful to Indian bluechips and thousands of due stocks quoting below the par value. In other words, the stock market will lose its sheen and investor's interest will dwindle further. This is likely to adversely affect the functioning of our stock exchanges in the form of reduction in trading volume, market capitalisation, listing fee-collected, etc.

Moreover, in case of an open offer by a parent MNC, the Indian shareholders know before hand that if they do not accept the open offer, they will be saddled with non-tradable shares after the delisting. Thus, the fear of losing their entire investment compels them to accept the offer. For example: - If an investor had purchased shares of an MNC say XYZ Limited in February 2000 at a price of Rs. 900 per share and the price dips to Rs. 300 per share in April 2002, then he would certainly not sell his shares and book such a huge loss; rather he would wait for some more time for the market to improve. However, if at this point of time, the parent

company makes an open offer to purchase the entire non-promoter shareholding at a price of Rs. 400 per share, then the investor has no option left but to tender his shares under the open offer. Thus, it looks as if the parent company is purchasing the shares at a 33 per cent premium to the current market price but actually the Indian investor is badly hit, because he is deprived of the opportunity to sell his holding in the stock market at a later date when the market improves. Our stock market is already in the bear phase and such open offers might kill our market permanently.

How to check this trend

5. From the above submissions, it is quite clear that the loss caused to the Indian shareholders by such open offers outweighs the gain of the parent MNCs. Thus, the trend currently being witnessed is not a healthy trend and the need of the hour is to take some urgent steps to arrest it. For this purpose, an amendment can be made in the takeover code. The amendment can be to the effect that no acquirer(s) shall be permitted to acquire more than 85 per cent of the paid-up equity share capital of a company, so that at least 15 per cent of the share capital is available as floating stock for trading in the stock market. If such an amendment is made, it will take care of interests of investors as well as the company's management, inasmuch as the investor will have ample investment opportunities in the form of wider choice and the management will be assured that there is no threat of any hostile takeover bid.

However, if the present provision for acquisition of the entire shareholding and subsequent delisting is to be continued in the same way as it stands today, then a different formula needs to be evolved for calculating the price at which the shares can be acquired under such open offers. This is necessary in order to ensure that the Indian shareholders at least get a fair price for the shares sold by them. It will be appreciated that the average of the weekly high and low of the closing prices, during the twenty-six weeks preceding the public announcement, is not the right criterion for determining the offer price in such cases, because the company's management can always plan and make a public announcement when the share is at its lowest price. Moreover, the aforesaid average of market price completely ignores the intrinsic value of the company's share as well as the future earning potential of the company. The formula should be such that it takes into account all the relevant factors that are used by analyst for valuation of shares. In the light of the above facts, it is suggested that SEBI should take some urgent steps to stop MNCs from deserting our stock market.