Requirement of Public Holding for Listing

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The Securities Contracts (Regulation) Act, 1956 (SCRA) seeks to prevent undesirable transactions in securities. In furtherance of this objective, the Securities Contracts (Regulation) Rules, 1957 (SCRR), framed under the SCRA, prescribes the requirements with respect to the listing of securities on a recognised stock exchange. One of the requirements prescribed in this regard endeavours to ensure availability of a minimum portion/number of shares (floating stock) of the listed securities so that there is reasonable depth in the market and the prices are not susceptible to manipulation. Since there is no direct means to ensure this, the SCRR prescribes a minimum size of the public offer that must be made by the company seeking listing on a recognised stock exchange. The listing agreement entered into between the stock exchange and the company requires the latter to ensure minimum non-promoter holding on a continuous basis. Administrative guidelines issued by the government and the regulator also endeavour to ensure reasonable floating stock in the market and avoid concentration of stock in few hands.

Rationale

A large number of shares in the hands of a large number of shareholders is essential for sustenance of a continuous market for listed securities to provide liquidity to the investors and to discover fair prices. Larger the number of shares and the number of shareholders, that is, larger the public float, the less is the scope for price manipulation. For example, if the promoters are entitled to, say 90% of the stock, it may result in concentration of shareholding up to 90% in the hands of a select few and shrinkage of floating stocks in the stock market. Given the imperfections in the Indian securities market, this could make the security susceptible to price manipulation to the prejudice of investing public and defeat the prime objective of the SCRA of preventing undesirable transactions in securities. Further, the larger the public float, the more effective is the instrument of listing as a weapon for re-distribution of wealth in the country. The minimum public float enables the general public to have a share in the increased wealth provided by competitive private enterprise and prevents cornering of the benefits flowing from policies of government and public institutions to such enterprises by a handful of promoters. This is why there is a requirement of minimum public offer/float under the SCRA. On the other hand, a too high a level of public float discourages closely held well-run profit making companies from going public. While the promoters want the benefits of listing, they generally shy away from giving a large share in the capital to public. A very high level also acts as disincentive to private enterprises. It is therefore desirable that the promoters are not only allowed to have a reasonable minimum stake, it should be insisted upon them to accept and retain a reasonably minimum stake in the capital of the company to demonstrate their interest.

Thus a very high (very low) level of public offer/float is not in the interest of promoters (public). While industry and public are interested in a lower and higher level of public offer/float respectively, the government/regulator need to strike a fine balance to meet the conflicting needs. It is, therefore, necessary to determine the size of public offer/float that does not offer scope for price manipulation prejudicial to the investing public, while not denying the necessary incentive to promoters. Such determination requires a systematic study of price behaviour of stocks for different levels of public float.

The minimum offer is generally prescribed at the time of initial listing while minimum float is prescribed for continued listing. These are also relaxed in public interest. These are prescribed in terms of a percentage of issue size, number of securities or value of securities or any combination of these three.

The prescription in terms of the value of public offer has no meaning in view of high volatility in the prices of securities in the market. The initial offer price

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of Rs. 100 per share could reduce to Re. 1 reducing the value of offer to public from Rs. 100 crore to Rs. 1 crore for an issue size of 1 crore shares. The prescription in terms of number of shares similarly has no meaning, as the shares do not have any fixed face value or market value. Two million shares in company 'A' is not the same thing as those in company 'B'. The percentage prescription is even more nebulous. 25% in company 'A' may mean a public offer of Rs. 0.25 crore, while the same in company 'B' can mean Rs. 2500 crore. As no single measure is adequate, a combination of these three is desirable and needs to be applied at the stage of initial listing and for continued listing. It must, however, still be borne in mind that the volume of transactions in a particular security in a day can be a multiple of the floating stock and no amount of floating stock can be an effective insurance against price manipulation. Effective enforcement and surveillance mechanism and legal framework are necessary to fight the menace of price manipulation.

Historical Perspective

Prior to September 1993, Rule 19(2) (b) of the SCRR required a minimum public offer of 60% of the issued capital of a company for listing on a stock exchange. The securities taken or agreed to be taken by governments or select financial institutions, up to a maximum of 11%, could form part of 60% of the pubic offer. It empowered the stock exchange to relax this requirement, with the previous approval of the central government, on being satisfied that the securities sought to be listed were not unduly concentrated in a few hands. It also empowered central government to waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by the SCRR. Depending on the circumstances, the minimum size of public offer was being relaxed frequently by administrative guidelines. A variety of relaxations was granted for FERA companies, new companies with foreign / NRI equity participation etc., while a variety of further requirements such as minimum issued capital, minimum public offer in terms of face value, minimum number of public shareholders, etc. were prescribed. Relaxations were granted for individual companies on a case-by-case basis as well as class of companies. A major relaxation was granted permitting non-FERA companies incorporated in India at least ten years prior to the date of the listing application or companies with a profit-earning record for at least four years out of five years prior to the date of the listing application to get listed on a stock exchange with a public offer of at least 40% of the issued capital. Besides, such public offer at the option of the company could be made in two stages, viz. the first 20% at the time of listing and the balance within three years of the date of enlistment with the regional stock exchange. Thus companies were allowed listing on the condition that they would make the second stage offer within three years to reduce their holding to 40%. It was a different matter that there was no proper mechanism to monitor if the companies actually made their second offer within three years of enlistment.

Rule 19(2)(b) was amended on September 20, 1993 by which the minimum public offer by a company for listing on a stock exchange was brought down to 25% from the earlier norm of 60% or such other percentage as was admissible under the guidelines of the government. This was done to encourage the listing of a large number of companies to broaden the market. The securities taken or agreed to be taken by governments or select financial institutions did not form part of 25% of the pubic offer. It restricted the power of the stock exchanges to relax this requirement only in respect of a government company with previous approval central government (SEBI from December 1996). It also empowered central government (SEBI from December 1996) to waive or relax the strict enforcement of any or all of the requirements with respect to listing prescribed by the SCRR.

As the authorities have powers to relax the requirements of listing, they were first persuaded to relax the minimum public offer requirement for information technology (IT) companies. The arguments in favour of the relaxation generally were: (a) since the IT stock were usually high value stocks, 25% of the capital could be a huge sum which these companies did not require; (b) many of these are first generation entrepreneurs who were not willing to allow as high a public holding as 25%; and (c) these companies in the absence of relaxation may raise resources in the overseas market which would be loss to the Indian investors. In exercise of its powers to waive or relax strict enforcement of any condition of listing, SEBI laid down a different set of requirements of listing for companies in the IT sector. It prescribed in 1999 that an IT company could be listed if

(a) at least 10% of securities issued by the company were offered to the public;

(b) at least twenty lakh securities were offered to the public (excluding reservation, firm allotment and promoters' contribution); and

(c) the size of the net offer to the public (i.e., the offer price multiplied by the number of securities offered to the public, excluding reservation, firm allotment and promoters' contribution) was at least Rs. 50 crore.

Subsequently in April 2000, SEBI laid down this set of listing requirements in respect of the companies in the media (including advertisement), entertainment and telecommunication sectors, subject to the condition that not less than 75% of the company's revenue and profit emanate from these sectors.

Current Requirements

It follows from the above that the SCRR required companies to make a minimum public offer. It did not require a minimum public allotment. It was only 25% of the issued capital irrespective of the value of the issued capital. Further, it was only an initial condition of listing, not a continuous requirement for continued listing. As a result, a company may be listed with 60% public offer, but in course of time, it may have a public float of much less than 60%. The prescription of minimum public offer did not ensure minimum public float. The SCRR did not even define public. By default it meant non-promoters - it included FIs, FIIs, MFs, employees, NRIs/OCBs, private corporate bodies, etc. As a result the shares available with retail individual public was much less than the prescribed minimum.

The requirements laid down by SEBI coupled with the requirements prescribed in the SCRR treated companies in different sectors differently, even though the nature of business should not have any link with shareholding pattern. All these coupled with discretionary powers to relax listing requirements helped India acquiring the dubious distinction of having highest number of listed stocks, while most of them are not traded even for years together. Just 10 out of about 10,000 listed stocks account for about 70% of total turnover. Needless to say that the environment became more conducive for price manipulation.

Most of these anomalies have been removed by recent amendments in the SCRR and the listing agreement. The SCRR was amended in June 2001 to provide that a public company seeking listing of its securities on a stock exchange is required to satisfy the exchange that at least 10% of each class or kind of securities issued by it was offered to the public for subscription. However, this requirement is subject to the following conditions:

a. minimum 20 lakh securities (excluding reservations, firm allotment and promoters contribution) was offered to the public;

b. the size of the offer to the public i.e. the offer price multiplied by the number of securities offered to the public was minimum Rs. 100 crore; and

c. the issue was made only through book building method with allocation of 60% of the issue size to the qualified institutional buyers as specified by SEBI.

If, however, a company does not fulfill the above conditions, it has to satisfy the exchange that at least 25% of each class or kind of securities was offered to the public for subscription. The stock exchanges can, however, relax listing requirements for a government company. The securities taken or agreed to be taken by governments or select financial institutions do not form part of 10% or 25%, as the case may be, of the pubic offer. With this amendment, SEBI has withdrawn special dispensation for select sectors. But it can still waive or relax the strict enforcement of any listing requirement under the SCRR.

In May 2001, SEBI directed the stock exchanges to amend their listing agreements to incorporate the requirement of quantitative continuous listing conditions to ensure availability of floating stock on a continuous basis. The listing agreements now provide that

(i) The company agrees that in the event of the application for listing being granted by the Exchange, the company shall maintain on a continuous basis, the minimum level of non-promoter holding at the level of public shareholding as required at the time of listing.

(ii) Where the non-promoter holding of an existing listed company as on April 01, 2001 is less than the limit of public shareholding as required at the time of initial listing, the company shall within one year raise the level of non-promoter holding to at least 10%. In case the company fails to do so, it shall buy back the public share holding in the manner provided in the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 1997.

(iii) The company agrees that it shall not make preferential allotment or an offer to buy back its securities, if such allotment or offer result in reducing the non-promoter holding below the limit of public shareholding specified under the SEBI (Disclosure and Investor Protection) Guidelines, as applicable at the time of initial listing or the limit specified in sub-clause (ii) for the existing listed company, as the case may be.

The stock exchanges have been advised by SEBI to monitor the level of non-promoter holding on a half yearly basis from the returns submitted by the companies. The non-promoter holding is required to be disclosed half yearly as a part of half-yearly disclosures by the companies.

Shareholding Pattern

The listing agreements have been amended to require the companies to disclose shareholding pattern on a quarterly basis within 15 days of end of the quarter. The stock exchanges and the listed companies are also obligated to post this information on their web sites. They have disclosed the shareholding pattern (in the proforma prescribed by SEBI) at the end of March 2001 and June 2001. Tables 1 and 2 have been constructed from such disclosure by the companies. These present the shareholding pattern at the end of June 2001, which is the outcome of the working of the requirement of public offer of 60% till 1993 and of 25% between 1993 and 2001.

Table 1 presents sector-wise shareholding pattern of 536 companies listed on NSE. It is observed that on an average the promoters hold nearly 50% of total shares. Though the non-promoter holding is more than 50%, Indian public held only 17.5% and the public float (holding by FIIs, MFs, Indian public) is at best 27%. There is not much difference in the shareholding pattern of companies in different sectors. Strangely, 62% of shares in companies in media and entertainment sector are held by private corporate bodies though the requirement of public offer was relaxed to 10% for them. The promoter holding is not strikingly high in respect of companies in the IT and telecom sectors where similar relaxation was granted. The table reveals the preference of different kinds of investors for companies in different sectors.

Table 2 is more interesting. It presents frequency distribution of the percentage of companies according to share of non-promoter holding. For example, it shows that non-promoters hold more than 60% of shares in about 35% of the companies. They hold more than 40% of shares in about 71% of the companies. This means promoters hold up to 60% and 40% of shares in about 71% and 35% of the companies respectively. If 60% public float is prescribed, only 35% of companies would be eligible for continued listing. Similarly, with 25% and 10% of public float, 93% and 99% of companies respectively would continue to be listed. If, however, a public float of 10% of securities plus 20 lakh securities plus Rs. 100 crore of securities with public is applied, only 24% of companies would continue to be listed. Most of the companies satisfy the requirement of listing in percentage terms, while most of them fail in terms of public float of Rs. 100 crore. If non-promoters must have at least 10% of securities which must be valued at least Rs. 100 crore, the company should have a market capitalisation of at least Rs. 1,000 crore. A company having a market capitalisation of Rs. 1,000 crore, in all probability, would be a fundamentally sound company.

Thus the alternative criteria are much more stringent both at the time of listing and also for continued listing. It is therefore unlikely that the companies would follow this route for listing of their companies when the alternative route of 25% is available. It is needless to mention that a company which fulfills the alternative criteria invariably fulfills the criterion of 25% public offer. If the alternative criteria are applied, one fourth of the companies listed on NSE and one tenth of companies listed on other exchanges would not continue to be listed.

Fine-tuning the Requirement

The authorities need to be complimented for their recent investor friendly measures, namely, alternative

Table 1: Shareholding Pattern of Companies Listed on NSE at the end of June 2001

(In per cent)

Sectors	Non-Promoters' Holding							Promoters' Holding		
	Institutional Investors			Non-Institutional Investors						
	FIs	FIIs	MFs	Indian Public	NRIs / OCBs	Private Corporate Bodies	Others	Indian Promoters	Foreign Promoters	Persons acting in Concert
Finance	18.30	5.62	3.24	18.51	0.67	4.38	10.76	38.21	0.12	0.30
FMCG	4.09	0.18	5.08	33.76	2.14	4.25	0.20	45.95	0.00	3.16
Infrastructure	15.77	2.61	6.15	19.83	3.01	9.19	1.44	33.57	4.24	4.20
IT	1.27	14.53	6.97	16.21	2.67	7.76	5.82	39.84	4.29	0.62
Manufacturing	8.08	2.39	6.03	16.71	2.29	3.94	0.93	53.68	3.81	2.15
Media & Entertainment	0.29	1.90	1.10	26.49	0.43	62.02	0.06	5.23	2.47	0.00
Petrochemicals	5.37	3.73	6.29	15.43	0.49	2.30	10.85	42.21	0.37	12.97
Pharmaceuticals	8.71	4.45	7.66	20.40	1.97	5.19	3.52	34.49	7.24	6.37
Services	5.84	3.47	3.42	22.44	1.12	4.64	2.87	48.51	3.54	4.15
Telecommunication	9.85	13.71	7.84	5.55	1.67	3.47	3.32	36.62	17.69	0.26
Miscellaneous	7.53	6.97	3.84	15.26	2.05	2.21	2.00	41.45	17.94	0.76
All Companies	**7.99**	**4.61**	**4.83**	**17.53**	**1.46**	**10.82**	**4.39**	**39.65**	**5.39**	**3.32**

Table 2: Non-Promoter Holding of NSE listed Companies at the end of June 2001

Sectors	Percentage of Companies with Non-Promoter holding of at least							
	60%	40%	25%	10%	20 lakh shares	Rs. 100 cr.*	10%, 20 lakh shares and Rs. 100 cr.	10%, 20 lakh shares and Rs. 100 cr. Or 25%
Finance	46.15	67.31	96.15	100.00	98.08	40.38	40.38	40.38
FMCG	33.33	58.33	100.00	100.00	100.00	8.33	8.33	8.33
Infrastructure	23.81	71.43	90.48	100.00	100.00	14.29	14.29	14.29
IT	37.50	90.63	100.00	100.00	100.00	40.63	40.63	40.63
Manufacturing	32.00	76.00	92.00	98.50	93.50	16.50	16.00	16.00
Media & Entertainment	33.33	72.22	100.00	100.00	94.44	22.22	22.22	22.22
Petrochemicals	50.00	80.00	95.00	100.00	100.00	55.00	55.00	55.00
Pharmaceuticals	38.71	67.74	93.55	100.00	90.32	45.16	45.16	45.16
Services	21.74	47.83	89.13	100.00	95.65	19.57	19.57	19.57
Telecommunication	30.77	69.23	84.62	100.00	92.31	46.15	46.15	46.15
Miscellaneous	36.36	71.21	92.42	98.48	87.88	24.24	22.73	22.73
All Companies	**34.51**	**71.46**	**92.72**	**99.25**	**93.84**	**24.63**	**24.07**	**24.07**

* Value of securities (Number of securities * Price at the end of June 2001) in the hands of non-promoters.

public offer criteria, requirements for continuous listing, uniform criteria for companies in different sectors and disclosure of shareholding pattern. The following paragraphs, however, discuss a few incidental measures, which could further strengthen public interest framework.

The current framework prescribes different standards for continued listing for existing listed companies and would be listed companies. The existing listed company is required to have non-promoter holding of at least 10%, while the would be listed company would maintain non-promoter holding at the level of public holding as required at the time of listing, that is, at 10% plus 20 lakh securities plus Rs. 100 crore or 25%. Thus existing listed and would be listed companies and consequently investors in these companies are treated differently. It would be better if all the companies are required to maintain the non-promoter holding at the level of the public holding required at the time of listing. That is, the companies listed before 1993 would maintain at 60%, the companies listed between 1993 and 2001 would maintain at 25% and the companies listed after 2001 would maintain at 10% + 20 lakh + Rs. 100 crore or 25%. This is all the more desirable because the investor subscribe to the shares of the company based on the understanding that the non-promoter holding would be maintained at the level required at the time of listing. In the alternative, all companies should be required to maintain non-promoter holding of 10% + 20 lakh + Rs. 100 crore or 25%. Further, the listing agreement as amended now provides that the companies would maintain public holding at the specified percentage. There is no indication as to how to achieve this. Can a company compel the promoters to divest their holdings? In case an existing listed company fails to do, it would be required to buy back the public shareholding in the manner provided in the SEBI takeover code. No such requirement has been prescribed for would be listed companies. Both the existing listed and would be listed companies should be required to buy back the public holding if they fail to maintain minimum public holding. In case the company does not buy back, would it be delisted? This needs to be clarified.

Similarly, there should not be any discrimination between a government company and non-government company. The powers of the stock exchange to relax any of the conditions of listing with the prior approval of SEBI in respect of a government company needs to be withdrawn.

In fact all powers of relaxation should be withdrawn. No body should have powers to relax the listing condition or lay down relaxed standards for listing or provide for conditional listing of any company or of any class of companies. This would prevent the mess we experienced in the past. All companies should be treated equitably and no authority should be able to favour anybody. The vested interest should not have an avenue for lobbying for relaxed standards.

The public offer is of no consequence unless the public are actually allotted shares. The SCRR should speak in terms of allotment to public, not just public offer. Only then the listing agreement can enforce minimum non-promoter holding required at the level of public shareholding at the time of listing.

As of now, there is nothing called public shareholding at the time of listing. And the word 'public' has not been defined. The words, 'offer to public', public shareholding', 'non-promoter holding' 'floating stock' etc. are creating confusion. By default 'public' means 'non-promoters' and include FIs, FIIs, MFs, employees, NRIs/OCBs, private corporate bodies, etc. The SCRR now permits 10% public offer subject to the condition that 60% of the issue is allocated to qualified institutional buyers (QIBs). Since QIBs are part of public, allocating 60% to QIBs would automatically constitute 60% public offer and the retail public would not get any share. Or, if 60% of public offer of 10% is allocated to QIBs, the retail public would be left with just 4%. It is therefore necessary to define 'public' and other terms and explicitly exclude allocation to QIBs from the public offer.

The proforma prescribed for submitting details of shareholding pattern to stock exchanges need to be explained to companies to avoid misunderstanding. A shareholder can simultaneously be a promoter, person acting in concert and a financial institution/corporate body. Unless explained properly, different companies show such holdings in different categories. This defeats any meaningful analysis.

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