# Rule of law and Corporate India

PREMIUM

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Corporate India has come up with lame excuses for not complying with the law on minimum public holding.

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It is fashionable these days, especially for corporate India, to carp endlessly about government failure and bad governance. In this general pessimistic environment it was very refreshing to read recently about the remarkable strides that India has made in improving

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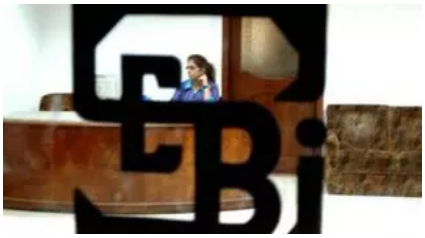

SEBI orders action against erring promoters of 105 cos

securities markets regulation, including the creation of world-class institutions, modern laws and their enforcement.

The obverse of this is a law abiding, progressive and modern corporate sector which is able to see beyond the next hour's profits. Corporate India has not lived up to this standard in at least one sphere, namely, the maintenance of minimum public holding for keeping a company listed on the stock exchange.

## Ensuring liquidity

It is a no-brainer that a large public

float of securities is necessary for a well-functioning market, so essential for liquidity and discovery of fair prices.

An illiquid market suffers from two main problems. Investors suffer large transactions costs when entering and exiting, and there is a heightened danger of market abuse.

Market abuse is the falsification of *information* about prices, spreads, turnover, etc. Innocent participants get sucked into making wrong decisions about investment when they see prices, spreads, turnover which

are not the result of normal market forces, but are caused by a deceptive scheme.

The possibility of market abuse, in turn, deters market participation and exacerbates illiquidity. This sets up a vicious cycle where fear causes illiquidity, illiquidity engenders market abuse, and the presence of market abuse causes fear. Securities market regulation therefore focuses on ensuring liquidity.

A liquid market benefits the investor. But it is equally in the interest of the listed company. Indian authorities have

been trying to ensure reasonable public float of listed securities by prescribing the minimum public offer at the time of listing and minimum public holding for continued listing.

The Government, through Rules in 1957, prescribed the minimum public offer of 49 per cent for listing. The Securities and Exchange Board of India (SEBI), through listing agreement in 2001, prescribed minimum public holding at the same level for continued listing.

However, based on corporate demands and lobbying, these

general prescriptions have been relaxed myriad times, including exceptions for categories of corporates and extension of time limits. In any case, no enforcement action was initiated against any defaulter over the last half century, thanks to the clout of corporate India, including PSUs.

Prescription of minimum public offer or public holding was notified only after widespread public consultations. For example, there was extensive consultation in 1971-72 which led to prescription of minimum public offer of

60 per cent in 1972 and also during 2008-09 which led to prescription of minimum public holding of 25 per cent in 2010.

Though corporate India was being persuaded since 2001 to maintain minimum public holding, the Rules in 2010 set a clear and firm timeline of three years.

## SEBI's spirited efforts

SEBI publicly expressed several times that it would adhere to the timeline, while providing innovative options to facilitate promoters and companies to

achieve the prescribed minimum public holding. These included the institutional placement programme, rights issue, bonus issue, offer for sale through stock exchanges, to name a few.

In August 2012, it encouraged companies to come up with other newer options as they find comfortable to achieve the purpose.

It also engaged in one-to-one discussion and correspondence with the many defaulting companies.

SEBI probably left no stone unturned to achieve minimum public holding. Clearly, this was

not a regulator mindlessly enforcing the law but a public spirited agency actively assisting the regulated entities to comply with the law.

Continuous public holding is a requirement under the Rules as well as the statutory listing agreement.

Non-compliance of these is a cognisable offence and invites action such as suspension/delisting of securities of the company from the exchange, imprisonment and a fine.

These are in addition to directions that SEBI can issue, including forced sale of excess

holding by promoters, debarring them from dealing in securities or from holding any responsible position in listed companies.

These are quite draconian measures to be imposed if the non-compliance is established. Admittedly, it is not very difficult to establish non-compliance of minimum public offer/holding. But for obvious reasons, SEBI did not initiate the process to establish the same except recently in the order dated June 4, 2013.

## Lame excuses

How did corporate India respond? Various lame

excuses were offered for not complying with the law. One, there were no takers for their shares. A company operating in the securities market knows the basic principle of the market — that it always clears if the price is right. There was a liquid market for shares of Satyam immediately after it became known that the company's books were cooked.

Second, the market was subdued. It did not remain subdued for *three years, or for that matter since 2001* when minimum holding was prescribed for the first time.

Third, the options available did not suit them. This is not true as SEBI volunteered to consider any other option that a company may suggest. The excuse which was not advanced explicitly was that the authorities had not taken such non-compliance seriously so far. As a result we have 100-plus listed companies (other than PSUs) which have not complied with the law.

This is not the only instance of non-compliance of law by corporate India. Though no firm data is available, thousands of companies listed on

exchanges do not comply with the listing agreement, particularly the provisions relating to corporate governance.

While the listing agreement is becoming longer, the level of compliance is declining. It is not surprising that the size of investor population as well as the amount raised through securities market in real terms has not increased over the last two decades despite a big increase in population and our dream growth rates.

In addition to good governance from the state, India equally needs an ethical

and law abiding corporate sector if inclusive growth is to be achieved.

The minimum public holding example is a relatively trivial one and one can see examples of non-adherence to the rule of law dharma by corporate India in the telecom sector, coal sector and mining.

The time has come to focus attention on this.

(The authors were both earlier with Union Ministry of Finance. The article does not necessarily reflect the views of their respective current employers.)

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