Indian Stock Market: Some Issues

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Among the developments of the Indian stock market highlighted in the *Economic Survey 2004-05* are:

- There was a rebound in primary market issues, particularly in Initial Public Offerings (IPOs) of equities.
- Household investor participation increased, based on stock market index returns of 72 per cent in 2003 followed by 11 per cent in 2004, and growing confidence in the transparency and robustness of the market design which was put in place over the period 1993-2001.
- The number of accounts with the National Securities Depository Limited (NSDL), a proxy for the number of participants in the market, which had nearly stagnated in 2002 at 3.8 million, grew by 21 per cent and then 29 per cent in the following two years to reach roughly 6 million as of end-2004.
- The average trade size on the National Stock Exchange (NSE) and the Stock Exchange, Mumbai (BSE) spot markets in 2004 was Rs. 27,715 and Rs. 23,984 respectively. This highlights the domination of individual investors in price discovery. If institutional investors (domestic or foreign) had been major players in this market, the average trade size would have been much bigger.

The *Economic and Political Weekly* (EPW) took objection to this line of argument and termed the effort as an 'attempt to underplay the prominence of FIIs, and highlight retail participation and the role of individual investors in price discovery'.[1] According to *EPW*:

- While market participation may have widened due to the improved performance of the stock market both in the secondary and primary markets, the information on individual depository accounts in NSDL by itself is not only incomplete, but can also be misleading.
- Unless one knows the number of retail investors, the size of their trades and their share in total volume, nothing conclusive can be claimed about individual investor participation driving down the average trade size.

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[1] 'Retail Investors: Wishful Thinking', *Economic and Political Weekly*, March 19-25, 2005, Vol. XL, No. 12, pp. 1080-1081.

- 97.3 per cent of retail applicants applied for eight issues in March and April 2004 at the cut-off price, implying that their role in price discovery was not significant.
- Not only are Foreign Institutional Investors (FIIs) the second largest (after the promoters) in terms of shareholding in Sensex companies, they also hold the largest chunk (37 per cent at the end of March 2004) of free-float or tradable shares of those companies, while retail investors in the quarter ended June 2004 held only 20.5 per cent of tradable shares in Sensex firms.
- In 2004, shares and debentures formed only 1.8 per cent of the financial assets of households.
- Rather than the unsubstantiated claims made in the *Economic Survey*, concrete steps to encourage retail participation might yield more fruitful outcomes.

There can be no dispute about the improvements in the trading and settlement system, which brought in a sea change in the overall trading environment. This has been aided, to a large extent, by the pressures applied and the support extended by international agencies and investors and technological developments. After all, India is no special case of such an achievement. Except for Nepal, all the four SAARC countries of significance have an automated trading system and depository services.

The official claims about the performance of the primary market during 2004, which rode the secondary market boom fashioned by foreign investors, cannot be contradicted in terms of the amounts raised. Unlike the *Economic Survey*, which compares across calendar years, if the performance is compared between financial years neither the amounts nor the number of issues in 2004-05 look as spectacular (See Tables 1a and 1b).

Table 1a
Primary Market

(Amount in Rs. Crores)

	2001	2002	2003	2004
(1)	(2)	(3)	(4)	(5)
Debt	4,916	3,451	3,790	2,383
Equity	726	2,373	2,892	33,475
Of which, IPOs	525	1,981	1,940	22,611
Number of IPOs	17	6	13	26
Mean IPO size	31	330	149	870
Total	5,643	5,825	6,682	35,859
Number	48	28	42	65

Source: INDIA, Ministry of Finance, *Economic Survey 2004-05.*

Table 1b
Primary Market

(Amount in Rs. Crores)

Issue Type	2001-02	2002-03	2003-04	2004-05
(1)	(2)	(3)	(4)	(5)
No. of Issues	35	26	57	60
Of which, Listed	28	20	36	37
IPOs	7	6	21	23
Amount Raised (Rs. Cr.)	7,543	4,071	23,272	28,256
Of which, Listed	6,341	3,032	9,630	15,874
IPOs	1,202	1,039	13,642	12,382

Note: Number of issues and the amount include issue of bonds and other securities.
Source: SEBI, *SEBI Bulletin*, April 2005.

The problem as we see it, is mainly with the basic issues and certain developments concerning the place and role of 'retail investors' in the Indian stock market. Attempts to seemingly side-step the real issues and instil a sense of comfort would make one uneasy about the commitment to make the market an equitable one not only for the promoters and intermediaries but also for individual investors whose money is sought to be made available directly to the corporates. In the following pages, we will make an attempt to examine these issues in detail.

Participation of Retail Investors

While the *Economic Survey* tried to draw comfort from the 'low' average trade sizes, these by themselves did not record any significant downward trend during the last three years even though they happen to be far lower than the averages for 2001 (See Table 2). Looking at this from the point of the financial year, the combined average trade size at BSE and NSE was no doubt lower in 2004-05 but definitely not significantly lower compared with 2001-02 and 2002-03. It can be seen that the average price of the shares traded fell substantially in 2004-05 indicating that the smaller companies were traded more. The low averages could be due to shares of smaller companies, whose market prices are relatively speaking generally lower but are getting traded in increasing numbers as a response to the shift in emphasis by the large investors. It is well known that the shares of medium size companies rose substantially during the year. While the NSE Nifty increased from 1912.25 at the beginning of January 2004 to 2052.85 at the end of March 2005, i.e., an increase of 7.35 per cent, the NSE Midcap 200 [2] shot up by 57.84 per cent during the corresponding period – from 1829.20 to 2887.20. The composition of trading at BSE also reflects the increasing role of relatively smaller companies resulting in a steep fall of the share of A group in January 2004, the share of A group[3] in the number of shares traded at BSE was 51.37 per cent, it fell to 27.81 per cent by March 2005. On the other hand, the share of B1 (including the subsequently created S group) increased from 34.61 per

2 Share price index of stocks whose average six months' market capitalisation is between Rs. 75 crores and Rs. 750 crores.

3 The grouping by BSE is based on certain qualitative and quantitative parameters which include the number of trades, value traded, etc. The A group is also called the Specified Group. The Z group includes companies which have failed to comply with the listing requirements and/or have failed to resolve investor complaints or have not made arrangements to dematerialize their securities.

cent to 47.04 per cent. Similarly, the share of B2 increased from 8.37 per cent to 10.96 per cent. (See Table 3) Further, it can be seen from Table 4 that the shares whose absolute market prices are lower (a few of these could be due to share splits) claimed an increasing share of the number of trades. This would obviously have impacted the average trade size.

Table 2
Average Trade Size

(Rupees)

Year	NSE	BSE	Year	NSE+BSE	
				Average Trade Size	Average Price
(1)	(2)	(3)	(4)	(5)	(6)
2001	40,509	35,783	2001-02	24,243	159.48
2002	26,703	22,485	2002-03	24,457	159.20
2003	26,993	22,782	2003-04	27,593	145.20
2004	27,715	23,984	2004-05	24,103	130.12

Source: INDIA, Ministry of Finance, *Economic Survey, 2004-05* for Cols. (1) to (3) *and SEBI Bulletin April 2005* for Cols. (4) to (6).

Table 3
Share of Different Groups of Companies in the Number of Shares Traded at BSE
January 2004 to March 2005

(Percentages)

Month	Group				Total
	A	B1 *	B2	T + Z	
Jan-04	51.37	34.61	8.37	5.64	100.00
Feb-04	66.12	24.54	5.99	3.35	100.00
Mar-04	66.45	23.39	7.46	2.69	100.00
Apr-04	54.79	38.65	5.55	1.01	100.00
May-04	64.19	29.91	5.23	0.67	100.00
Jun-04	72.56	21.02	5.73	0.68	100.00
Jul-04	60.04	32.88	6.10	0.98	100.00
Aug-04	54.27	31.39	11.53	2.81	100.00
Sep-04	41.86	38.54	14.63	4.97	100.00
Oct-04	39.56	39.21	14.62	6.61	100.00
Nov-04	31.17	38.68	19.45	10.70	100.00
Dec-04	26.47	48.07	14.11	11.34	100.00
Jan-05	25.55	48.28	11.79	14.38	100.00
Feb-05	22.54	52.64	13.20	11.62	100.00
Mar-05	27.81	47.04	10.96	14.19	100.00
Average Price per Share in Mar-05 (Rs.)	*230.92*	*59.51*	*19.92*	*22.358*	*97.56*

* From Jan-05, this includes the newly created S Group.
Source: Based on BSE Key Statistics for the corresponding months.

Table 4
Increasing Share of Lower Priced Shares in the Number of Trades

(Cumulative Percentages)

Price Range	2001	2002	2003	2004	2005 (up to March)
Less than Rs. 5	1.03	1.95	1.87	2.04	2.55
5 – 10	2.14	4.43	4.98	5.03	6.41
10 – 50	10.54	18.13	25.13	25.27	36.42
50 - 100	26.08	32.37	40.04	40.15	55.33
100 - 500	78.97	88.70	88.55	85.44	89.21
500 & above	100.00	100.00	100.00	100.00	100.00

Based on daily opening prices on BSE.

Even more importantly, the participation of retail investors should mean that they buy and sell in a significant manner, or at least they hold on to the shares already owned by them. If they are engaged primarily in selling, it means that they are withdrawing from the market rather than actively contributing to the price discovery mechanism. When small shareholders sell, the size of the trade will necessarily be small irrespective of the nature of the buyer. There have been indications to the effect that individual shareholders may be exiting rather than remaining in the market. Between March 2004 and March 2005, in about 72 per cent of the companies with market capitalisation of at least Rs. 500 crores, the share of the Indian public has declined. In fact, the larger the size range in terms of market capitalisation, the greater the proportion of the number of companies experiencing a decline in the share of the Indian public. That this phenomenon has been a continuing is evident from the fact that the *actual number of shareholders* in the lowest ranges of shareholding, which are expected to be dominated by individual shareholders, decreased in many prominent companies during 2003-04 (See Table 5). In fact, in 24 out of the 30 companies constituting the BSE Sensex for which we could get the size-wise distribution of shareholding, only in the case of Ranbaxy Labs, there was a marginal increase in the number of shareholders in the lowest range (up to 50 shares). It can also be seen that, whenever available, the data on the number of individual shareholders reflects a similar pattern.

The decline in the number of shares in the lowest ranges could either be due to sell-offs in the normal course or following a share buyback announced by the companies concerned. Had the shareholding pattern furnished by the companies to the stock exchanges at the end of every quarter contained just one more column i.e., the number of shareholders, the analysis could have been conclusive. Obviously, corporates need not make any additional effort to provide this information.

One also finds a large number of individual shareholders exiting after the listing of an IPO. It can be seen from Table 6 that in most companies, the number of shares held by the Indian public fell while FIIs increased their holdings. In a few cases, which did not do too well at the stock market, the share of individuals increased while that of FIIs fell. SEBI has recently increased the proportion of shares reserved for retail individual investors, in a 100 per cent book-built issue, from 25 per cent to 35 per cent while simultaneously it has revised the definition of the retail investor as someone who applies for securities having a value of not more than Rs. 1 lakh. The previous limit was Rs. 50,000. If the individual investors do not hold on to the shares and make a quick exit by making some capital gains, and the shares more often end up in the hands of institutional investors, especially foreign ones, what is the rationale in reserving shares for the public? If the objective is to let Indian household savings flow into the stock market, will reservation be of much help?

On the other hand, if only their entry is important and not their remaining in the market, what prevents one from reserving even a higher portion of the issues to them? Going a step further, let the individual investors bid first and only in case of a shortfall let the remaining portion be thrown open to all investors. Instead of helping only a few lucky domestic individual investors, a good number of whom may not retain the shares, let larger numbers benefit. Policy makers obviously have no control over individuals' behaviour post-listing. With promoters being allowed to retain/acquire majority equity, the floating stock turns out to be quite limited. If in the remaining portion, institutional investors have a major say very little room is left for individual investors.

What happened during the year was that Mumbai's position in the combined turnover at BSE and NSE increased at the expense of almost every other location in India. The only marginal gainer (by 0.02 percentage points) was Chennai. Mumbai's combined share of BSE and NSE is now 56.13 per cent against the 53.63 per cent earlier. Thanks to Mumbai the share of the top 10 locations increased from 80.25 per cent to 81.29 per cent. Among the locations of significance, the turnover at Mumbai increased by 8.33 per cent while that at Chennai increased by 4.75 per cent. It is thus apparent that the regional spread if at all is limited and there are tendencies at consolidation. Mumbai's pre-eminent position might be indicative of the fact that most institutional investors, including FIIs are based in Mumbai.

In any case, it appears that individual shareholders have been following the trends initiated by FIIs. For instance, for a common set of 2,400 companies, during December 2003 to March 2005, changes in the composition of the value of the shares held by FIIs and the Indian public across different BSE listing groups followed a similar pattern (See Table 7). The main difference, however, is that the trends initiated by FIIs were accentuated by individual investors. Overall, however, within each of the groups while FIIs increased their share, that of individual investors declined (See Table 8). It should be seen whether the latter get caught in the smaller and less significant companies or will they be able to ride out at the appropriate time in times of a downward trend.

Who Owns How Much?

Going by the ownership of listed companies' shares at the end of 2004, it is evident that a few FIIs are far more important for the Indian stock market when compared to the entire set of Indian individual investors. At the end of December 2004, FIIs' share of the overall market capitalisation was 12.87 per cent whereas the share of the Indian public was 11.64 per cent. Mutual Funds (MFs), which are supposed to be investment vehicles for individual investors, rank very low with less than 3 per cent of the overall market capitalisation (See Table 9). The dominance of FIIs becomes even more apparent in the case of index shares. While FIIs claim 20.85 per cent of the market capitalisation of BSE Sensex companies, the share of the Indian public is only about 11 per cent. Even in companies that form a part of BSE 100, NSE Nifty and NSE Nifty Junior, FIIs have a much larger presence. In case of public sector enterprises too the share of FIIs is much larger than that of the Indian public.

It is another matter if the shareholdings reported by the companies under the individual category might include friends and relatives of the promoters, stock brokers and employees[4] of the same companies. As was indicated by us in the *Alternative Economic Survey 2001-2002*, the 'Private Corporate Bodies' hide many

[4] In June 2004, Infosys reported the 4.92 per cent shareholding of employees separately. The share of Indian public was 16.39 per cent. In September 2004, however, there was no mention of employees and shareholding of Indian public was reported to be 20.77 per cent, thereby implying that the shareholding of employees was clubbed with that of the public. The guidelines for reporting the shareholding pattern are silent on this respect.

Table 5
Illustrative Cases of Companies with Decreasing Number of Shareholders in the Lowest Ranges of Shareholding

	Company	Shareholding Range (No. of Shares)	No. of Shareholders 2002-03	2003-04	Decrease (%)
	(1)	(2)	(3)	(4)	(5)
1	***Zee Telefilms***	Up to 5000	211,411	147,408	-30.27
2	***Reliance Energy***	Up to 100	85,642	60,246	-29.65
3	***Larsen & Toubro Ltd***	Up to 500	467,472	343,193	-26.59
4	***Satyam Computer Services***	Up to 500	153,781	113,131	-26.43
5	***Hindalco Industries***	Up to 100	132,056	99,379	-24.74
		Individuals	145,109	110,523	-23.83
6	Mahindra & Mahindra	Up to 100	85,734	66,717	-22.18
7	***Grasim Industries Ltd***	Up to 100	210,863	165,703	-21.42
		Individuals	*234,077*	*184,047*	*-21.37*
8	***Jindal Iron & Steel***	Up to 500	45,634	36,072	-20.95
9	***ICICI Bank***	Up to 1000	564,492	450,810	-20.14
10	Tata Tea	Up to 500	85,519	68,730	-19.63
		Individuals & Others	91,037	73,710	-19.03
11	***ITC Ltd***	Up to 500	159,933	132,418	-17.20
12	***Hero Honda Motors***	Up to 500	45,587	37,925	-16.81
13	Voltas Ltd.	Up to 500	69,073	57,801	-16.32
14	***HDFC Bank Ltd***	Up to 500	248,168	209,274	-15.67
15	***Tata Iron & Steel***	*Individuals*	*657,767*	*557,584*	*-15.23*
16	***HPCL***	Up to 500	102,486	87,443	-14.68
17	Jindal Vijaynagar Steel	Up to 5000	771,460	659,103	-14.56
		Individuals	*831,847*	*748,294*	*-10.04*
18	***Infosys Technologies Ltd.***	Up to 100	67,170	57,486	-14.42
		Individuals	*72,858*	*63,466*	*-12.89*
19	***Wipro Ltd***	Up to 500	54,782	47,046	-14.12
20	***ACC***	Up to 50	52,321	44,949	-14.09
21	MTNL	Up to 100	51,647	44,825	-13.21
22	ABB Ltd*	Up to 1000	43,535	37,886	-12.98
23	Glaxo Smith Kline Pharma*	Up to 100	92,085	80,455	-12.63
24	Bombay Dyeing & Mfg. Co.	Up to 50	56,698	49,626	-12.47
25	Siemens Ltd	Up to 500	41,454	36,870	-11.06
26	Indian Hotels Co. Ltd	Up to 250	52,745	47,264	-10.39
27	Dabur Ltd	Up to 1000	49,386	44,280	-10.34
28	Sterlite Industries Ltd.	Up to 1000	26,499	23,905	-9.79
29	Escorts Ltd*	Up to 100	50,738	46,029	-9.28
30	Jindal Strips Ltd	Up to 500	46,352	42,132	-9.10
31	***HDFC Ltd***	Up to 500	87,959	80,253	-8.76
32	Arvind Mills Ltd	Up to 500	167,974	153,328	-8.72
33	Procter & Gamble Hygiene	Up to 500	23,933	22,028	-7.96
34	***Dr. Reddy Labs***	Up to 5000	51,232	47,583	-7.12
35	Essar Oil Ltd.*	Up to 500	456,742	424,387	-7.08
36	***Hindustan Lever***	Up to 5000	356,302	332,767	-6.61
37	***Tata Power***	Up to 500	157,206	147,105	-6.43
38	Nestle India Ltd.	Up to 500	43,999	41,474	-5.74
39	Asian Paints (I)	Up to 100	26,374	24,985	-5.27
40	Motor Industries Ltd	Up to 100	11,346	10,757	-5.19
41	Bharat Forge	Up to 500	26,684	25,592	-4.09
42	***Bajaj Auto***	Up to 100	15,021	14,428	-3.95
42	***Tata Motors***	Up to 100	126,021	121,223	-3.81
43	***Cipla Ltd***	Up to 500	31,246	30,066	-3.78
44	***Bharti Tele-ventures Ltd***	Less than 500	32,656	32,171	-1.49

Source: Company Annual Reports.
* Data for 2001-02 & 2002-03 respectively.
Note: Names of Sensex companies are given in bold italic.

Table 6
Changes in the Shares held by Indian Individual Investors and FIIs after IPO

Name of the Company	Shareholding of the Indian Public at the end of the Quarter Following the IPO			Shareholding of the Indian Public as on 31-12- 2004		Change in the No. of Shares held by Public [(5)-(3)]/(3)*100	Change in the No. of Shares held by FIIs (%)
	Quarter ending	No. of Shares	Share in Total (%)	No. of Shares	Share in Total (%)		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1. Patni Computer Systems	Mar-04	7,187,128	5.76	2,845,710	2.28	-60.41	100.35
2. Maruti Udyog	Sep-03	22,473,500	7.78	13,284,258	4.60	-20.08	16.17
3. Dishman Pharma	Jun-04	716,219	5.22	450,721	3.28	-37.07	140.27
4. Divi's Labs	Mar-03	2,560,322	19.97	1,665,689	12.99	-31.70	413.11
5. Indiabulls Financial	Sep-04	9,896,247	9.10	6479,594	5.96	-34.52	157.82
6. Surya Pharmaceuticals *	Mar-04	2,625,504	25.08	1792,206	17.12	-31.74	Nil
7. Power Trading Corp	Jun-04	29,049,990	19.37	20,119,487	13.41	-30.74	77.53
8. I-Flex Solutions #	Jun-02	15,487,944	41.51	108,06,020	30.02	-27.49	220.74
9. Bharti Tele-Ventures	Mar-02	20,603,070	1.11	17,064,618	0.92	-17.17	197.49
10. Petronet LNG	Jun-04	192,341,040	25.65	165,231,399	22.03	-14.09	46.50
11. Bank of Maharashtra	Jun-04	76,053,072	17.67	68,518,024	15.92	-11.00	New Acq.
12. Tata Consultancy Services	Sep-04	33,428,719	6.96	29,673,399	6.18	-11.23	31.01
13. New Delhi Television @	Jun-04	4,565,907	7.51	4,333,155	7.13	-5.10	0.00
14. Four Soft Ltd	Jun-04	6,757,940	21.21	6,663,389	20.91	-1.40	28.21
15. TV Today Network	Mar-04	6,608,607	11.39	6,813,282	11.75	3.10	Nil
16. Biocon	Jun-04	16,543,329	16.54	19,453,734	19.45	17.59	-80.43
17. Datamatics Technologies	Jun-04	2,418,740	5.96	3,042,238	7.50	25.78	-19.00
18. Indraprastha Gas	Dec-03	17,887,466	12.78	25,468,637	18.19	42.38	-34.66

* The company did not report any FII shareholding.
\# After adjusting for 1:1 bonus shares issued in September 2003.
@ The Company did not report any change in the FII shareholding.
New Acq: While FIIs did not hold any shares at the end of June 2004, they had held 3249538 shares at the end of December 2004.

Table 7
Distribution of Market Value of Shares owned by FIIs and the Indian Public According to Different BSE Listing Groups

BSE Listing Group	Shareholder Category	Quarter Ending					
		Dec. '03	Mar '04	Jun '04	Sep '04	Dec. '04	Mar '05
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A	FIIs	97.77	98.16	97.87	97.59	96.77	95.82
	Indian Public	80.39	83.11	81.97	79.76	76.86	75.27
B1 *	FIIs	2.18	1.81	2.05	2.32	3.08	3.81
	Indian Public	16.73	14.44	15.19	17.15	19.21	20.42
B2	FIIs	0.03	0.02	0.05	0.07	0.10	0.17
	Indian Public	1.55	1.33	1.54	1.65	2.12	2.39
T + Z	FIIs	0.03	0.01	0.03	0.03	0.04	0.20
	Indian Public	1.33	1.12	1.31	1.45	1.81	1.92
All Groups	FIIs	100.00	100.00	100.00	100.00	100.00	100.00
	Indian Public	100.00	100.00	100.00	100.00	100.00	100.00

Note: Refers to 2,400 common companies for which data on shareholding pattern and market capitalisation are available for all the six quarters.
* Including the newly created S group.

Table 8
Shares of FIIs and the Indian Public in the Market Capitalisation of Different Listing Groups at BSE

BSE Listing Group	Quarter Ending Dec. '03	Mar '04	Jun '04	Sep '04	Dec. '04	Mar '05
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Share of FIIs						
A	12.86	14.21	14.52	14.76	15.69	16.72
B1 *	2.72	3.05	3.17	3.16	3.95	4.81
B2	0.38	0.33	0.68	0.87	1.25	1.92
T+Z	0.26	0.23	0.48	0.37	0.42	1.50
All Groups	11.65	13.11	13.30	13.32	14.02	14.82
Share of Indian Public						
A	11.21	10.78	11.22	11.20	10.70	10.65
B1 *	22.17	21.79	21.67	21.69	21.17	20.87
B2	22.06	19.93	19.70	20.15	21.82	21.77
T+Z	13.59	15.62	18.99	15.83	14.91	11.72
All Groups	12.36	11.75	12.26	12.37	12.04	12.02

Note: Refers to 2,400 common companies for which data on shareholding pattern and market capitalisation are available for all the six quarters.
* Including the newly created S group.

promoter group companies as well. The group of 'Any Other' would also include independent directors and their associates and relatives. Thus, the share of independent individuals could be possibly lower and that of those related to the company that much higher.

In the background of such dominance of FIIs, it would be difficult to accept that the Indian public can influence the course of the stock market.

Table 9
Shares of Different Categories of Investors in Market Capitalisation (As on December 31, 2004)

(Percentages)

Investor Category	All Companies	Sensex Cos.	Companies common to BSE 100, Nifty and Nifty Junior	Public Sector Cos.
(1)	(2)	(3)	(4)	(5)
Promoters (foreign & Indian)	56.97	45.04	54.80	75.38
Non-Promoters	43.03	54.96	45.20	24.62
Mutual Funds	2.95	3.01	3.03	2.01
Banks & Financial Institutions	6.08	7.87	6.83	4.00
FIIs	12.87	20.85	15.78	7.67
Private Corporate Bodies	3.27	2.31	2.29	1.31
Indian Public	11.64	10.88	10.10	4.87
NRIs/OCBs	2.18	2.83	2.22	0.48
Others incl. GDRs/ADRs, etc.	4.05	7.21	4.95	4.28
Total	100.00	100.00	100.00	100.00
Number of Companies	*3129*	*30*	*117*	*93*

Source: Based on the data of 3,129 companies for which data on both shareholding pattern and market capitalisation are available for the period ending 31st December 2004.

Demat Accounts

The *Economic Survey* interprets the increase in the number of demat accounts as indicative of an increasing participation of retail investors. There, however, appear to be two main reasons for the fast increase in the number of demat accounts. First is the improvement in the primary market. It has now become practically mandatory for investors whether small or large to have a demat account as most new issues are available through demat only. It is well known that many large company issues were over-subscribed multiple times during the recent past. Since it is a pre-requisite to have a demat account to participate in the IPO book-building process, and because of the substantial over-subscription, not all applicants would be allotted shares. Even if successful, they would be allotted only a few shares, which many of the investors are likely to dispose-off following the listing of the shares. Since a good number of new small investors enter the market through the primary route and they tend to exit quickly on listing, it is likely that a large number of demat accounts would either be holding a nominal quantity of shares or they remain dormant. It is relevant to note that the number of demat accounts with NSDL appear to have fallen from 40 lakhs at the end of February 2002 to about 32 lakhs by the end of February 2003 – a fall of 20 per cent in just one year.

In any case, the credit for the huge increase in demat accounts goes to the number of mega public offers made during the last one year or so. Credit is also due to private sector banks, many of them new, who have been offering free demat accounts to promote their business. In fact, IDBI Bank's website says: 'Open 4 free demat accounts with your savings accounts'! It is also inevitable that the drive towards progressive dematerialisation would only force ordinary investors to open demat accounts. It is not necessary that all the accounts will have some shares and that all of them will remain active once the shares acquired through the public offers are sold off. Going by past experience it could well be that the accounts are concentrated in a few States. Maharashtra, Gujarat and Delhi accounted for as much as 55 per cent of the 46.63 lakh demat accounts with NSDL (excluding the 9.47 lakh unclassified ones) at the end of August 2004. The share of the top eight states works out to about 85 per cent. Maharashtra and Gujarat together account for 42 per cent of the total accounts. Thus the spread is once again limited.

The opening of new demat accounts in a sense is forced on the investors and depository participants are doing their bit to popularise them. Therefore, not all the growth appears to be muscle. A considerable part appears to be a swelling that could disappear in a flash.

Some Characteristics of Individual Investors

According to the SEBI-NCAER Survey of Indian Investors, almost half of the households are such where the head of the household has studied only up to matriculation. Even though there may be others in the household with higher educational qualifications, it does not automatically follow that every graduate understands the nuances of the market and how a particular company, industry and the economy perform. By the same token, not every office-goer is well equipped to invest in the stock market. At best, most individual investors can be good followers.

The Survey underlines the characteristics of the investors who most certainly have little understanding of companies and their operations. The fact is that these investors rely more on the media for information and depend less on balance sheets -- 70 per cent of the investor households are reported to rely on newspapers and journals. Friends form the second most important source, followed by television. Only about 34 per cent of the investor households reportedly go through prospectuses of companies. There is thus a large scope for rumours, motivated news reports and manipulation through 'analysts' and 'experts'. None of these are accountable to the shareholders. It is understandable that such investors tend to follow press reports about the changes in FII investment and the FIIs focus only on certain sectors and companies.

There, however, seems to have emerged a new class of investors vaguely termed as High Networth Individuals (HNI) who are high income salaried employees, professionals like lawyers, doctors, self-employed people, bureaucrats and artists who have money but may not have the time and expertise to follow the daily market movements. Recent press reports indicate that HNIs have been heavily subscribing in public issues and are engaging portfolio managers. If one looks at the bulletin boards of investment websites, it appears that a new breed of young people have been actively following market developments. They may be accessing online trading facilities from browsing centres, brokers' terminals, from home or even from their office computers.

It is another point that in a globalised world, information needs of investors are even greater and decision making that much more complex. To what extent a majority of the individual investors in India have the time, resources and knowledge to assess different sectors, companies and impact of day-to-day developments in different parts of the world is a moot point. It would be revealing to assess the awareness of the individuals who dabble in the shares of Infosys and TCS everyday as also the nature of their activities, their strengths, weaknesses and the opportunities awaiting them. Similarly, it is debatable how many of the retail investors have ever heard of Alan Greenspan, Chairman of the US Board of Governors of the Federal Reserve System, let alone what impact his decisions will have on their fortunes. While it is said that the ordinary investor should invest through mutual funds, in the Indian case it has turned out that even MFs have become vehicles for investment by corporate bodies and institutions and possibly high networth individuals.[5] For instance, in 2003 it was brought out that a majority of the assets managed by MFs are owned by corporate bodies and institutions. In case of private sector MFs, the percentage is even higher at almost two-thirds (See Table 10). It is a different matter that the ordinary investor would be equally baffled with the hundreds of MF schemes.

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[5] In fact, large investors bear lower costs in dealing with mutual funds compared to the smaller ones. Interestingly, the Chairman of the Association of Mutual Funds in India explained this phenomenon as: 'Like any other large buyer, a wholesale investor would expect to receive wholesale rates, and that is the logic for wholesale plans. This is not only because the cost of serving such wholesale investors is lower, but it is also an industry measure to ensure that rebating is eliminated. (See: http://www.businessworldindia.com/aug1604/indepth05.asp)

Table 10
Unit Holding Pattern of Mutual Funds
(As on March 31, 2003)

Category	Private Sector			Public Sector MFs (Including UTI MF *)			% To Total Net Asset Value (Private & Public Sector MFs)
	Number of Investors Accounts	Net Asset Value (Rs. Crores)	% to Total Net Asset Value	Number of Investors Accounts	Net Asset Value (Rs. Crores)	% To Total Net Asset Value	
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Individuals	4,001,841	17,956.48	31.68	11,555,665	14,734.64	64.27	41.07
NRIs/Ocbs	38,416	723.02	1.28	45,895	155.49	0.68	1.10
FIIs	1,317	528.51	0.93	741	33.16	0.14	0.71
Corporates/ Institutions / Others	250,972	37,465.91	66.11	74,007	8,003.62	34.91	57.12
Total	4,292,546	56,673.92	100.00	11,676,308	22,926.91	100.00	100.00

* The erstwhile UTI has been divided into UTI Mutual Fund (registered with SEBI) and the Specified Undertaking of UTI (not registered with SEBI). This data contains information only of the UTI Mutual Fund.
Source: http://www.sebi.gov.in/mf/unithold.html

Investors' Major Concerns

A survey of Indian investors identified their topmost concerns as: (i) corporate governance; (ii) volatility; and (iii) price manipulation (See Table 11).

Table 11
Greatest Worries of Household Investors About the Stock Market

Greatest Worry	All Sample Households	Household Monthly Income (Rs.)				
		Up to 10,000	10,001 - 15,000	15,001 - 20,000	20,001 - 25,000	Over 25,000
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Fraudulent company managements	27.5 (17.4)	20.7	26.7	33.0	27.2	29.5
2. Too much price volatility	22.6 (30.0)	29.3	26.3	22.2	16.9	16.2
3. Too much price manipulation	16.2 (31.7)	14.4	19.8	11.7	16.2	18.8

Note: Figures within brackets relate to the survey April-June 2001.
Source: NSE, *Indian Securities Market : A Review*, Volume VI, 2003, p. 11.

The first concern is related to Corporate Governance (CG). The process of improving CG in India in its present form is mainly a response to international developments namely the East Asian Financial Crisis and the corporate scandals of USA. It is not as if the Companies Act, 1956 did not have any elements of CG. Weak provisions and poor implementation have been the bane of the Act. Following the recommendations of the Kumar Mangalam Birla Committee report in February 2000, SEBI required listed companies to follow a CG code in a phased manner. Provisions were introduced through Clause 49 of the Stock Exchange Listing Agreement which requires companies to have, among others, a certain minimum proportion of independent directors depending upon whether the chairman is also the chief executive or not[6] and to have board sub-committees to deal with audit, remuneration and investor grievances. Some of the provisions like the constitution of a remuneration committee, however, are not mandatory. Interestingly, the code does not refer to the nomination/appointment committee which could have played an important role in the election/continuation of directors. The code was initially made applicable to all companies in the BSE 200 and Nifty indices, and all newly listed companies, as of March 31 2001. This was extended to companies with a Paid Up Capital (PUC) of Rs. 10 crores or with a net worth of Rs. 25 crores at any time in the preceding five years, as of March 31 2002. In respect of other listed companies with a PUC of over Rs. 3 crores, the requirements were made applicable as of March 31 2003.

Private managements probably did not oppose the introduction of independent directors initially because first, it was difficult for them to openly oppose the international trend and second, they had the freedom to decide on a director's independence. Added to that, as has been mentioned above, some other components were either missing or were not binding on them. Many instances have been found where companies overlooked obvious linkages to confer independence on individuals probably taking advantage of this freedom.[7] Friends, long time associates, partners of legal firms serving the same company have all been termed as independent directors. In one case, the managing director of a subsidiary was designated as an independent director and was even made the chairman of the Audit Committee!

Experience with the implementation of CG code has underlined the need to further strengthen the provisions. A SEBI study of reporting practices of listed companies noted that '(V)ariations in the quality of annual reports, including disclosures, raises the question whether compliance is in form or in substance; and emphasise the need to ensure that the laws, rules and regulations do not reduce corporate governance to a mere ritual'.[8] To the best of our knowledge, SEBI has never made this report public. In the background of the enactment of Sarbanes Oxley Act, 2002 in America and the recommendations of the Naresh Chandra Committee appointed by the Department of Company Affairs, the Narayana Murthy Committee appointed by SEBI recommended the definition of an independent director. Based on these recommendations, SEBI amended the Listing Agreement in August 2003 to tighten the criteria for the independence of directors. However, following suggestions and representations on the revised criteria, SEBI convened another meeting of the Committee and announced that the implementation of the Revised Clause 49 of the Listing Agreement was being deferred till further notice. In October 2004, SEBI withdrew the August 2003 amendments and announced a further

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6 In case of a non-executive chairman, at least one-third of board should comprise of independent directors and in case of an executive chairman, at least half of board should comprise of independent directors.

7 See for instance: K.S. Chalapati Rao and Pratap Chandra Biswal, 'Shareholding Pattern of Listed Companies in India: Implications for Protection of Minority Shareholders' Interest', a presentation made at the International Conference of Privatisation and Corporate Governance of State-owned Assets, organised by the Indian Council of Social Science Research and OECD Centre for Cooperation with Non-Member Countries, New Delhi, 27-28 November 2003.

8 Securities and Exchange Board of India, *Report of the SEBI Committee on Corporate Governance*, February 2003. Chairman: N.R. Narayana Murthy.

revised clause which was to be implemented by the existing listed companies by April 1 2005. In early March 2005, however, the date for ensuring compliance with the Revised Clause 49 of the Listing Agreement was extended up to December 31 2005 as it was brought to the notice of SEBI that a large number of companies were still not in a state of preparedness to be fully compliant with the requirements.

The private sector seems to have successfully lobbied against the introduction/implementation of stricter provisions. A reading of the latest version of Clause 49, introduced in October 2004, suggests that the private sector has successfully lobbied against the introduction/implementation of stricter provisions. It is a compromise at least in respect of the crucial provisions of (i) criteria for an independent director; (ii) responsibilities of independent directors; (iii) audit committee functioning; (iv) subsidiaries; (v) related party transactions; and (vi) whistle blower policy (See Table 12 for details). Under the new dispensation, most subsidiaries would remain outside the purview of the corporate governance code. With the freedom to define 'material transactions' and 'ordinary course of business', most related transactions could escape the scrutiny of the audit committee. Given the choice, except for a few, no company would venture to formulate a whistle blower policy. Even more importantly, the addition of the words *which may affect independence of the director* will once again give the incumbents some leeway.

In this context it is worth referring to the amendments to the Companies Act, 1956. The experience of amending/recodifying the Act, since the beginning of the 1990s has been that changes favourable to company managements went through smoothly, at times even through an ordinance. Those seeking to restrict their freedom have been subjected to examination by expert committees, working groups, discussions, debates, and so on. With the private sector raising the banner of 'Are we going overboard on Corporate Governance?' the process of revamping the Companies Act has got stalled once again. The Companies (Amendment) Bill 2003 was withdrawn[9] and in its place a Concept Paper on the reform of the Companies Act, 1956 was floated by the government in August 2004. An Expert Committee headed by a leading private sector personality, with seven sub-groups assisting it, is now examining the Paper. The Committee has representations from major chambers of commerce and industry, professional bodies, government officials, legal experts, representatives of banks and financial institutions. However, there is no one from an investor association and not even an academic who could have brought in the outside investors' view point!

The issue now seems to have been given the colour of a power struggle between SEBI and the Ministry of Company Affairs (MCA) with the latter reported to be holding the view that 'the listing agreement though binding on companies has lesser legal sanctity than the Companies Act'. FICCI, on its part, has chipped in by saying that 'duplication of powers between SEBI and ministry of company affairs should be avoided' and has expressed the hope that 'SEBI would amend Clause 49 of the Listing Agreement, if required, once the new Companies Act is finalised by the

[9] In all three bills (1993, 1997 and 2003) were dumped in the process.

Table 12
Important Amendments to Clause 49 of the Listing Agreement

Earlier Provisions (August 2003)	Changes introduced in October 2004
Independent Director	
The expression 'independent director' shall mean non-executive director of the company who apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its senior management or its holding company, its subsidiaries and associated companies;	The expression 'independent director' shall mean a non-executive director of the company who apart from receiving director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates *which may affect independence of the director*.
Responsibility of Independent Director	
Independent director shall however periodically review legal compliance reports prepared by the company as well as steps taken by the company to cure any taint. In the event of any proceedings against an independent director in connection with the affairs of the company, defence shall not be permitted on the ground that the independent director was unaware of this responsibility.	--
Subsidiary Companies	
The company agrees that provisions relating to the composition of the Board of Directors of the holding company shall be made applicable to the composition of the Board of Directors of subsidiary companies.	At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a *material non listed Indian* subsidiary company.
Related Party Transactions	
A statement of all transactions with related parties including their basis shall be placed before the Audit Committee for formal approval/ratification.	A statement *in summary form* of transactions with related parties *in the ordinary course of business* shall be placed periodically before the audit committee. Details of material individual transactions with related parties which are not in the normal course of business shall be placed before the Audit Committee.
Audit Committee	
The audit committee should invite such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and when required, a representative of the external auditor shall be present as invitees for the meetings of the audit committee.	The audit committee *may invite* such of the executives, as it considers appropriate (and particularly the head of the finance function) to be present at the meetings of the committee, but on occasions it may also meet without the presence of any executives of the company. The finance director, head of internal audit and a representative of the statutory auditor *may be present* as invitees for the meetings of the audit committee.
Whistle Blower Policy	
Personnel who observe an unethical or improper practice (not necessarily a violation of law) shall be able to approach the audit committee without necessarily informing their supervisors.	Non-Mandatory Requirements: The company *may establish a mechanism* for employees to report to the management concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy. Role of Audit Committee: To review the functioning of the Whistle Blower mechanism, *in case the same is existing*.

Source: Based on a comparison of the two versions.

(expert) committee'. The Chairman of the Expert Committee which is examining the Companies Act Concept Paper is credited with the view that '(I)t is very difficult to ensure independent directors on a company's board through legislation'. It is thus unlikely that the Committee will recommend stricter criteria for the independence of directors. Since it is likely that the shape of the new Companies Act will be known well before the December 2005 deadline for the implementation of the Revised Clause 49, it can possibly be expected that the Clause could be further watered down.

Another development which is inimical to the retail investors is increasing volatility. While the *Economic Survey* sees the positive side of volatility, it needs to be underlined that high volatility makes decision making that much more difficult for the ordinary investor. Last year witnessed an escalation in volatility (See Table 13) and volatility might force some long-term investors to rethink their approach to the market. With the promoters already well-entrenched, they can continue to pick and choose the directors 'independent' or otherwise, and continue to enjoy full operational freedom.

Table13
Increased Volatility in 2004

Stock Price Index	Daily Volatility			
	2001	2002	2003	2004
(1)	(2)	(3)	(4)	(5)
BSE Sensex	1.71	1.10	1.17	1.59
Nifty	1.62	1.07	1.23	1.73
Nifty Junior	1.93	1.34	1.37	1.94

Source: INDIA, Ministry of Finance, *Economic Survey, 2004-05.*

Transparency and Information Flow

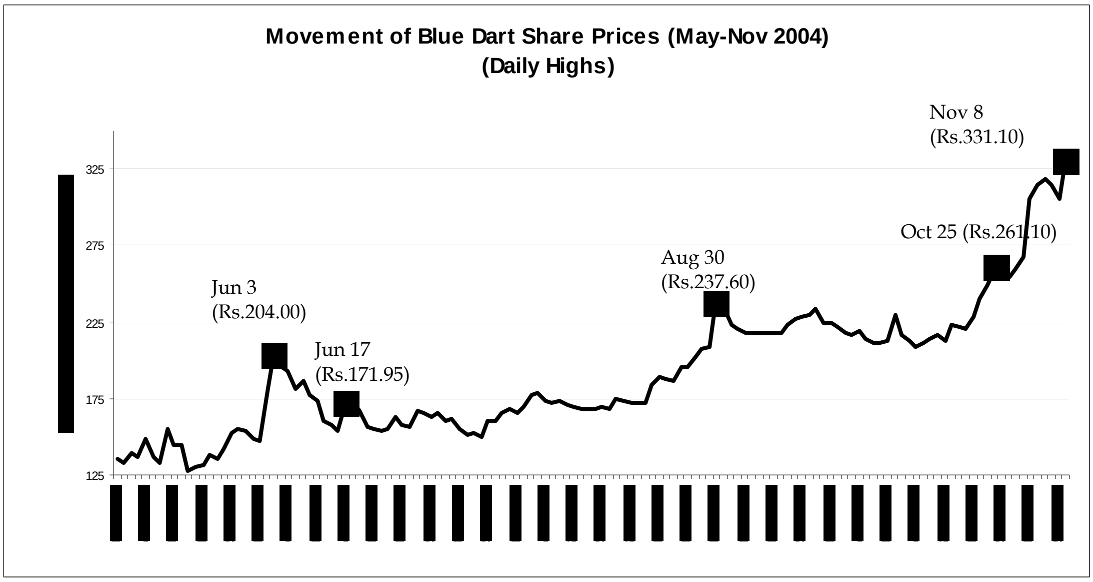
Choosing stocks to invest in the stock market is often likened to throwing darts. The experience of some who traded in the shares of Blue Dart Express Ltd. (Blue Dart), during the few months preceding its takeover by DHL, however, may not have been such a random exercise. For them, the news of DHL taking over Blue Dart would not have come as something out of the blue. Commentators say that such informed trading aimed to take advantage of major corporate events is not uncommon in India. While there is an obvious need to look into this phenomenon closely to protect the interests of ordinary shareholders, we do find that Blue Dart offers a good case for understanding the larger issues of corporate disclosures, insider trading and the role of venture capital and the media. Hence, we are giving a detailed presentation of this case which also partly addresses the third major concern of the investors: price manipulation.

Repeated Rumours and Price Spurts

First things first. The suggestion of a foreign company taking equity stake in Blue Dart was not new. In July 2003, it was rumoured that Deutsche Post World Net (the parent company of DHL) would make an open offer for the company's shares. This was promptly denied by the company. The rumour, possibly based on the ongoing five-year sales agreement between Blue Dart and DHL, which came into effect on 1 October 2002, however, did not have any perceptible impact on the company's share price. From early June 2004, however, rumours of a possible takeover repeatedly caused sharp increases in the company's share price. In the first instance of its kind during the year, the share price reached the yearly high of Rs. 204

on June 3 2004 only to fall by 25 per cent within a fortnight of the company's clarification on 4 June that there was no basis for the newspaper reports (See Figure 1 and Table 14). A short revival was again broken by the company's announcement on 18 June. Once again, beginning from mid-August, the price picked up smartly to appreciate by more than 37 per cent to reach Rs. 237.60, a yearly high, on 30 August. The company's denial of any move by the promoters to sell their shares broke this rally. The next rally which started around 7 October was broken by the company's announcement on 26 October that it had no knowledge of the promoters entering into any agreement to sell their shares. The denial was possibly in response to press reports, quoting investment bankers, on the same day, that 'Blue Dart is finalising a strategic deal with a multinational firm', and which suggested that DHL was the most likely suitor.

Figure 1



This time around, however, the company's share price picked up again within two days and appreciated by about 25 per cent to climb to Rs. 318 by 3 November. The final price agreed upon between the original promoters and DHL being Rs. 350 per share, anyone who had bought the shares even at that highest price (Rs. 318) would have made a decent gain of 10 per cent within a short time indicating that some persons had a fairly good idea of the final price offered by DHL. According to press reports on 3 November, market analysts indeed claimed that though the scrip had staged consistent bull runs in the past on the basis of rumours, a deal was being finalised this time around and the final price was Rs. 350 per share. It was also suggested that the promoters mopped up over 8 lakh shares from the open market. Understandably, the market analysts did not believe in the company's denials and as such the share price continued to increase. Incidentally, these spurts were accompanied by steep rises in trading volumes and the number of trades. For instance, during the four days prior to the 26 October announcement, the average number of shares traded on BSE were nearly 90,000 compared to about 6,000 in the initial four trading days of the month. The corresponding number of transactions were 5,926 and 123 respectively.

Table 14
Select NSE Corporate Announcements Regarding Blue Dart

09-07-2003	The company denied having any knowledge about the source of the article which referred to the German postal group Deutsche Post World Net's intention of making an open offer for the company's shares at about Rs. 120 nor did it appoint any merchant banker as reported in the report. Deutsche Post DHL's parent company
16-04-2004	The Company informed NSE that Mr. Clyde Cooper, Managing Director, bought 6,00,000 equity shares from his wife Mrs. Farida Cooper.
04-05-2004	NSE was informed by the Company that Mr. Clyde Cooper acquired 21,73,414 shares of the company on April 29 and 30, 2004 (18,51,445 shares by way of gift and 3,21,969 shares by way of off-market purchase). The shareholding of Mr. Clyde Cooper after the acquisition reached 16.60 per cent.
04-06-2004	Responding to press reports that DHL might take a stake in Blue Dart, the Company said it was unaware of any agreement to sell the shares of any of the major shareholders to DHL. On 3 June, i.e., a day prior to the announcement, the Company's share price reached the yearly high of Rs. 204.
18-06-2004	The Company denied any knowledge of off-loading of its shares to international courier company DHL at the price of Rs. 250 or any other price. Nor was it aware of the reason for the increase in the trading activity of its shares or the price increase. It did not find any record of any transaction involving the promoters from the weekly reports received from the depositories. The share price which was again picking up, fell following this announcement.
24/25-06-2004	Mr. Clyde Cooper told the press that he was approached by 'several parties' but he had not entered into any agreement to sell his share to DHL or any body else. 'I do receive enquiries from time to time from various parties. I have not reached any agreement with anyone,' he said
31-08-2004	Reacting to press reports, the Company explained that it was not aware of any stake sale or strategic placement of its shares. Reacting to queries about a possible alliance with Temasek Holdings, Mr. Tushar Jani, Chairman of the Company, however, told the press that, 'I am not authorised to talk on the issue at the moment' and suggested that the journalists approach an executive in charge of the development, who however, was not available. On 30 August , the share price reached a further high of Rs. 237.60. Following the clarification, it retracted once again.
13-09-2004	The Company informed NSE that Mr. Tushar Jani, Chairman, acquired 8,67,000 shares of the Company on 31 August 2004 by way of a gift from his family members taking his total holding in the company to 4.71 per cent.
26-10-2004	Once again in response to press reports the Company said it was 'not aware of any stake sale or private placement of shares'. Once again a day earlier, the price had reached a yearly high of Rs. 261. Unlike earlier, however, the denial had only a limited impact. The share price recovered within two days and climbed up to Rs. 300+ before the eventual announcement.
08-11-2004 9:51 AM	Finally, within a fortnight of its denial, Blue Dart informed NSE that the Indian promoters, along with the persons acting in concert, and Newfields Holdings Ltd. had separately informed the Company that they had entered into separate definitive sale/purchase agreements to sell their equity shares collectively constituting 68.21 per cent of the total current paid up equity share capital at Rs. 350 per share of the Company to DHL Express (Singapore) Pte Ltd.

Source: Except for the item relating to 24/25-06-2004 and part of the one dated 31-08-2004 which are based on press reports, the remaining are based on the announcements available from the NSE website: www.nseindia.com

The Final Round

Within a fortnight of its latest denial on 26 October, the company announced on 8 November that the Indian promoters, along with the persons acting in concert, and Newfields Holdings Ltd. (Newfields) separately informed the company that they had entered into separate definitive sale/purchase agreements to sell their equity shares collectively constituting 68.21 per cent of the total current paid up equity share capital at Rs. 350 per share of the Company to DHL Express (Singapore) Pte Ltd. Subsequently, going by the time stamps of the Corporate Announcements, the public came to know of the agreement on the 8 November through the stock exchanges – time stamp of NSE's announcement read 9:51 am i.e., just a few minutes before the commencement of the day's trading, and on BSE the time stamp read 10:36 am, *i.e.*, well after the commencement of trading.

What is probably more important is that even on the morning of 8, November, *The Times of India* (Delhi edition), quoting sources, reported that DHL was 'close to acquiring' Blue Dart. On 8 November none of the daily newspapers, including the financial papers that we had checked, reported on the finalisation of the deal. We failed to notice any information relating to the sell-off during our initial visits to the company's website. Later on we did find under the inconspicuous **What's New?** a 'Notice to the Stock Exchange' which contained a pdf (stockex.pdf) version of the letter dated November 6, 2004 from the Blue Dart's Company Secretary to NSE regarding the sale of promoter's equity in the company to DHL. Incidentally, the letter also referred to the sale of its holding by Newfields. That the web link would not have been there on the company's website prior to the announcement by the NSE is evident from the fact that the file was created at 1:22 pm on 8 November, just after the creation of the Managing Director's general letter to customers. Interestingly, the Managing Director, also a party to the sale agreement, tells the customers that 'I am pleased to inform you that earlier today, we have been informed by our Board of Directors that DHL has made an offer to acquire a majority stake in Blue Dart.' That is, an agreement entered into on 6 November was not known to the public officially till 8 November and that too almost till the commencement of trading that day. One could, however, take a position that the agreement could have been finalised late in the day on 6 November, a Saturday, and even if the company had sent its communication to NSE that day, NSE could only look at it on the morning of 8 November, a Monday, and that NSE had put the information on its website first thing in the morning. While NSE does not put up any announcements on Saturdays, BSE does sometimes do it till late in the evening. Is it that Blue Dart did not inform the public earlier because it wished to inform the stock exchanges first? But how come *The Times of India* of 8 November made it a certainty? Was the information leaked to a select few? Or, do newshounds have a way of tapping the right sources? Since stock exchanges start putting up the announcements from 9:30 onwards, and Blue Dart's announcement was not among the very first that day, it is likely that the communication had reached NSE only on Monday morning and the BSE much later.

Going by the quarterly filings of the shareholding pattern, there was no change in the overall shareholding of the company's promoters and persons acting in concert, between 31 March and 30 September 2004. However, as reported to the National Stock Exchange, some important developments took place in April, May and August of 2004. There was a consolidation of the promoter shareholding as two of the promoters acquired shares from some of their family members through gifts/off-market deals.

What one notices, however, is that during the entire episode, the FIIs seem to have behaved in an interesting manner. Particularly two FIIs had gradually built up their position and finally exited completely after December 2004 when DHL made an open offer for the non-promoter shareholding (See Table-15). On the other hand mutual funds, especially the Indian ones, behaved in a stable manner. It thus appears that some FIIs could have made a fortune in the process. It would be worth enquiring on whose behalf the FIIs were doing the purchasing.

Table 15
Changes in the Shareholding of Select Categories of Investors
in Blue Dart Express Ltd

(Percentages)

Investor Category/Investor	At the End of			
	Jun-04	Sep-04	Dec-04	Mar-05
(1)	(2)	(3)	(4)	(5)
FIIs - Total	0.94	2.87	5.86	0.00
of which,				
- Goldman Sachs Investments (Mauritius) Ltd	-	*2.00*	*1.83*	-
- Merrill Lynch Capital Markets Espana SA	-	-	*3.74*	-
Mutual Funds & UTI - Total	10.28	9.75	8.69	9.34
of which,				
- UTI Mutual Fund	*1.45*	*1.45*	*1.42*	*1.42*
- SBI Mutual Fund	*2.32*	*2.32*	*2.50*	*4.60*
- Principal Mutual Fund	*2.00*	*1.71*	*1.35*	*1.35*
- Prudential ICICI Trust Ltd	-	-	*1.32*	*1.12*
- Templeton Mutual Fund	*3.61*	*2.91*	*1.66*	-
Indian Public – Total	*11.80*	*10.77*	9.10	4.72

Note: The total number of shares of the company remained the same during the entire period.

Now we turn to the role of venture capital. Going by publicly available information, it is evident that Newfields Holdings Ltd., entered into a simultaneous sale agreement along with the promoters. Newfields is wholly owned by Asia Pacific Fund II, a direct investment fund advised by Schroder Capital Partners Ltd. (SCPAL) and belongs to the Schroder Ventures Group. The Chairman of Schroder Capital Partners Ltd. (SCPAL), Singapore, is on the Board of Blue Dart as a nominee of Newfields and is shown as an independent non-executive director. His alternative on Blue Dart's board is another partner of SCPAL, who is based in Mumbai. The latter is on the Company's Audit and Compensation Committees as an independent non-executive director. Other investee companies in India reported by SCPAL are: (i) Apollo Hospitals Enterprise Ltd. (Apollo), (ii) Indraprastha Medical Corp Ltd., (iii) Orchid Chemicals and Pharmaceuticals Ltd, and (iv) Strides Arcolab Ltd. The fund's nominees are on the boards of all these companies. Interestingly, however, these nominee directors are shown as 'independent' non-executive directors by some companies and by others they are reported merely as non-executive directors. The

Chairman of Apollo in turn is on the Board of Parkway Holdings, another investee company of Schroder Ventures possibly as a nominee of an investor because he was not being elected but re-appointed to the Board. Incidentally, Parkway has a joint venture in India with Apollo by the name of Apollo Gleneagles Hospital Ltd. These facts reflect a close relationship between SCPAL and the Apollo group. In spite of this, the fund's representatives on the Apollo Hospitals Board were treated as independent directors.

Venture capitalists look for clear exit routes for their investment such as IPOs or a third-party acquisition of the investee company. It is, therefore, not surprising that Newfields was a part of the negotiations which might have been going on for quite some time and probably the prime motivator for the deal. For instance, the purchase offer by DHL suggests that the two Share Purchase Agreements (one with Newfields and the other with the Indian promoters) are inter-related – if one expires or gets terminated, the other would automatically get terminated. As indicated earlier, one of the promoters was resisting the sell-off and press reports suggest that Schroder Capital played a key role in making all the promoters agree.

Should a venture capital, for its own benefit, force a change in management? In this case, additionally, it transpired that a leading domestically-owned company became an MNC arm thanks to the efforts of the fund. Should such funds, who most probably are privy to a lot of price sensitive information and who might also possess the right to restrict the management's freedom, be treated as insiders or as outside investors? This has implications for insider trading as well as a director's independence vis-à-vis a company.

The United Breweries (UB) and Scottish & Newcastle Plc (S&N) Deal: A Contrast

Given this experience with Blue Dart, United Breweries (UB) offers a good contrasting case of keeping the public informed of corporate developments. Talk of UB having a strategic partner was going around for quite some time. As a result, the company's share price jumped from about Rs. 125 at the beginning of October 2004 to Rs. 500 by 17 December 2004. Almost a month earlier, on 22 November, the company informed that 'some unsolicited offers for strategic alliance are presently under evaluation' by its Board. The announcement also referred to the Company Chairman's mention of certain unsolicited offers received for strategic alliance in the Annual General Meeting (AGM) on 28 September 2004. On 20 December 2004, the financial press prominently reported the deal struck between UB and Scottish & Newcastle (S&N) Plc. At about 11:00 am on that day, BSE had put up the Company's announcement which stated that the Company's Board of Directors (BoD) at the meeting held on 18 December 2004 (a Saturday), had approved the strategic alliance with S&N. The details offered by the announcement make it apparent that the press reports were mainly based on the Company's release and that the deal might have been made public on Sunday.

While this shows that UB appeared to be quite open with the information on the deal, Blue Dart was quite reluctant to admit the goings on.

What are the provisions with regard to information disclosure in such circumstances? What are the obligations of different parties involved -- the company, the promoters and the major shareholders? Are the regulations clear and adequate to protect the interest of ordinary shareholders?

It is evident that negotiations for the takeover of Blue Dart were going on for quite some time. The process took time possibly because one of the promoters of Blue Dart was against the sell-off.[10] The repeated price spurts were, therefore, not without any basis. It is difficult to comment on the Company's repeated denials of the impending takeover. As a company, Blue Dart might justify its position by saying that the promoters had not informed it in writing about the goings on. However, the promoters, since they are also in the management, cannot claim that they had no knowledge of the matter. Then who was feeding the market with rumours? In such situations, the promoters could hope to get an even better price based on market spurts. The information could have been leaked out from any of the sources: promoters, venture capital, investment banker, the acquirer. Interestingly, SEBI seems to have never shown any interest in this case in spite of the sharp jumps and dives of the Company's share price. One hopes that this case study helps focus on related issues.

Summing Up

The official understanding of the increasing role of small investors in the Indian stock market appears to be based on weak grounds. Low average trade sizes and increasing number of demat accounts have their flip sides. Individual trades would be necessarily low when small investors either buy and sell, or mainly sell. It is immaterial who the buyers are when small investors sell – these could even be institutional investors, foreign or Indian. Having been stuck for a long time in a bearish market, individual investors might try to leave the market by taking advantage of the upswings in share prices -- temporary or somewhat sustained. This might have been happening during the last two years. Past experience suggests that the space vacated by individual shareholders could be getting filled by FIIs. Interestingly, we had highlighted the declining shares of the Indian public and the increasing share of FIIs in the *Alternative Economic Survey, 2001-2002*. It was also brought out that while individual investors were trapped in poorly performing companies, they exited the better ones.

In 2004-05, however, retail investors could simultaneously have been attracted by the sharp increase in prices of relatively non-prominent companies (like the B2, T and Z groups of BSE). By following the trends initiated by FIIs, the small investors ended up lagging behind the FIIs in most trading groups of BSE. By increasing their reliance on the smaller ones, the individual investors could have also increased their overall risk. The issue of small shareholder participation would become a little clearer once the company annual reports for the year 2004-05 become available. The government, having access to more direct information could have based its observations on concrete evidence instead of offering weak indirect evidence. It is also inexplicable why the government wishes to underplay the role of foreign institutional investors. A few FIIs dominate the entire set of individual investors especially in index shares.

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[10] 'The Logistics Industry: Milking the Opportunity', *Businessworld*, November 22, 2004.

There is heavy concentration of stock exchange trading in a few states/cities. There is an element of compulsion in the opening of demat accounts which also exhibit a fairly high degree of concentration. It appears that a considerable proportion of the demat accounts could be dormant or would have nominal shares. Thus their capacity to genuinely reflect the involvement of individual investors becomes limited.

The real issue, however, is should small investors necessarily be encouraged to participate in the stock market directly? If the objective really is to increase their participation, IPOs/fresh issues of capital could be made a two-tier affair. At the first stage the entire issue could be reserved for them and at the second stage, say after a gap of three days, the under-subscribed portion, if any, could be thrown open to everyone. 'P' in IPO would then indeed stand for the Indian public. As of now, theoretically, the share of retail investors would work out to just about 9 per cent (35 per cent of 25 per cent) after an IPO. Venture capital has a vested interest in keeping the public offer small at the time of IPOs so that the issues can command high premium and deliver huge capital gains on their investments. Similar is the case with promoters.

It is now obvious that policy makers do not see majority stakes by promoters as undesirable. They have indeed encouraged such a development. Changes in company law and SEBI guidelines since the early 1990s, such as share buy-back, liberal provisions for inter-corporate investments, creeping acquisition and low non-promoter equity, have all enabled promoters to consolidate their control. . It now turns out that the larger the company, the greater the control of the promoters. Thus if promoters are allowed to acquire/retain majority stakes and institutions occupy a good part of the remaining space, individual investors will remain on the fringes of well-run and profitable companies. If their participation has to be increased, there is no escape from limiting the shares of the promoters and institutional investors.

High participation of individual investors is, however, double-edged. If their stakes are large, the cost of servicing them would be high and the monitoring of managements would be weak, but the fruits of enterprise would probably be spread among a larger number of Indians. Also, given the well known characteristics of small investors, it remains debatable how best they make their investment decisions, especially in a globalised situation. They are more likely to be trapped in difficult situations as compared to large investors. On the other hand, if the promoters' stakes are high, one may expect that they would be more committed to the enterprise and the remaining shareholders (including individuals) would automatically benefit from such a commitment. The high stakes do not, however, prevent promoters from expropriating non-managerial shareholders.

No doubt, at one time the issue indeed was the very low stakes by those managing the affairs of the companies. The change in the ownership structure during the past one and a half decades, however, has drastically altered this context. Earlier, at least there was some possibility of public financial institutions acting as a check on the managements. Indeed, the introduction of the joint sector was an attempt to balance different interests. With a 25 per cent stake, the private promoter was left with enough incentive for making the venture a success. The 26 per cent stake by the public financial institutions gave them somewhat of a veto power to block all major decisions and the 49 per cent equity by the public (including other categories of investors) facilitated meaningful resource mobilisation. With the chairman being a nominee of the institutions and other representatives of the financial institutions being on the board, there was enough scope for a dispassionate examination of issues. It is a different matter why and how this experiment did not

> **Small Investors BEWARE**
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> After the six straight days of gain the market took a breather and has resumed its rally again. The market sentiment seems to have improved following positive inflows by FIIs and MFs over the last few days judging by the favourable advance decline ratio.
> The interesting thing however is that thought most of the index stocks seem to languish major action is seen in the small and midcap stocks.
> Looks like the operators are back in business, manipulating the market and guess who is going to get trapped in the game. The SMALL INVESTOR. Sebi needs to be more pro-active and not just sit as a silent watcher.
> The small investor is easily tempted by the big percentage gains clocked by several midcap stocks. They are not able to pick the better stocks among the duds and invariably get stuck with bad stocks and make a loss. A lot of money has been raised by mutual funds to invest in midcaps and a lot of FIIs have also been buying midcaps. The only difference is that they know what they are getting into and will be able to exit when the time comes. The small investor will not. So BEWARE.
>
> http://moneycontrol.com/msgboard/viewfullmsg.php?topicid=159995&usr_msgid=847719
> A message posted on the bulletin board of Moneycontrol.com 12th May '05

always yield fruitful results. For finding out the reasons one needs to go into the details of the implementation of the scheme. It suffices to say that even when there was no private promoter some of the government companies when converted into joint sector ones did perform extremely well. India seems to have missed an opportunity of building an ideal ownership structure which while making the promoters genuinely interested, would also have kept them on tight leash. What she is now trying to do is super-impose outside systems on a vastly different ownership structure.

In India, there is no record of FIIs shunning family managements even in the face of widely reported major corporate governance failures. Typically, they are interested in maximising their own benefits rather than having their actions impacting overall interests. Other institutional investors too have not displayed any tendency to play a pro-active role in the post-liberalisation period. The mutual funds industry is shifting more towards private sector management. It also involves some large private promoter groups. These groups which have their own governance problems cannot be expected to stand up and speak against incumbent managements. In the relatively smaller companies any way, there is very little presence of institutional investors. There again, the promoters have enough freedom.

High promoter stakes also limit the market for corporate control, a strong disciplining mechanism by the market. In fact, under the takeover regulations, exemptions far outweigh open offers both in terms of the numbers and the amounts involved (1,691 against 553 and Rs. 28,300 crores vs. Rs. 19,650 crores respectively during 1997-98 to 2004-05) The number of cases where management change has taken place have been declining progressively: from 70 in 2000-01 to 35 in 2004-05.

Even when there is a change it is well known that it is a case more of mutual consent than of contest. In spite of SEBI tightening the rules governing exemptions in September 2002, the number of exemptions increased from 171 to 212 and the corresponding amount from Rs. 1,436 crores to 6,958 crores.

One school of thought, however, prefers the managements to concentrate on long-term growth rather than worrying about short-term profits and day-to-day price movements. Should India allow private promoters the security of control and let the other shareholders remain satisfied with whatever the promoters deem reasonable to declare to the public so that the investors will remain attracted and the companies would survive and grow (but not at the same pace had the managements not indulged in siphoning-off)? While such growth may be good in one sense, it may lead to undue concentration of economic power in a few peoples' hands. Should one ignore such a concentration of economic power? Should the lion's share of the fruits of enterprise accrue to a limited few in multiple ways?[11]

Granting that high promoter stakes could have their own positive side, the question still remains about the form of their participation. Is it through the promoters' own resources or is the stake of listed companies already controlled by them? If it is their own stake, how was it built up – through honest earnings or by siphoning-off from the companies and adopting unfair means like insider trading, etc.? Is the ownership structure such that the promoters control is disproportionately high compared to their *real* risk? One needs to examine the ownership structure further to find answers to these questions.

Having already granted control to the promoters, the official efforts are now directed at restricting their operational freedom through the Corporate Governance Code. It should be underlined that these efforts, which were initiated towards the end of the 1990s, are more a response to international developments than to a genuine internal assessment of the situation. Private managements did not oppose the induction of independent directors initially because first it was difficult to openly argue against the international trend and second, they had the freedom to decide on the independence. The stricter provisions of 2003, a response to major corporate scandals in USA and the enactment of the *Sarbanes Oxley Act, 2002*, were diluted in 2004. Private managements have pitted the Ministry of Company Affairs against SEBI and have already successfully lobbied against the introduction/implementation of stricter provisions of the 2003 code. The code may further be revised as per the amended/new Companies Act to remove some more of its bite.

If in the name of the Corporate Governance Code weak provisions are put in place, and given the stranglehold of promoters, these would hardly serve the objective. The entrenched promoters would never willingly let themselves be disciplined. The independent directors would remain ornamental. At best the arrangement may satisfy international investors. An indication of the present state of

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[11] With the opening up of the economy for foreign capital of all types, a very rough estimate puts that out of the Rs. 14,400 crores dividend distributed by private sector companies in 2003-04, the share of all kinds of foreign entities at 36 per cent of the total. The Indian promoters' share works out to 28 per cent and the direct share of Indian public at about 17 per cent.

affairs could be inferred from the following observation of the Naresh Chandra Committee which was forced to state that:.

> The Boards, and their committees, should not merely have meetings *pro forma* prior to a nice lunch. The shareholders have a right to know how much time the Board and its committees spent in discussing the shareholders' interest. The committee, therefore, recommends that duration of Board/committee meetings be disclosed.[12]

A critical element of the code is the composition of the board. Given the ownership structure, it is extremely difficult to visualise that genuinely independent directors would get elected to corporate boards. As of now, it appears that even the shareholding data furnished by the companies is not put to any scrutiny. One wonders whether the regulators are equipped to go into the details. If that is the case, how can one expect to cross check the independence of directors which requires an enormous amount of information. Even existing provisions of the Companies Act, such as cumulative voting and representation by small shareholders, which could have enabled the entry of others, are hardly used. For this, the Act itself has to be blamed because of the clear escape routes that it has provided. One way out, therefore, is to frame suitable rules and regulations so that very little scope is left for pliant directors to use their discretion and take a stand favourable to the promoters/managements. Deterrent disincentives, such as disqualification in the case of auditors, act as further safeguards. Interestingly, however, there have been arguments against making independent directors liable for omissions and commissions because it could scare away many genuine independent directors. While there is merit in this proposition, it also raises the question of compulsions for the directors to act independently? Thus, greater accountability of independent auditors and all directors and more transparency may deliver better results than the institution of (elusive) independent directors and their committees.

At present the independent auditor is appointed by the shareholders (which in effect means those in control of the management). Why should it be the prerogative of shareholders only? After all, audit has implications not only for the shareholders but also for the stakeholders. There is a need to think of the manner in which company auditors are appointed or removed. Also, independent institutions need to be developed/strengthened which could play the role of an effective countervailing force.

The case of Blue Dart demonstrates the need to improve the investigative mechanism. At present, investigations into price manipulations, insider trading and information disclosures seem to be more a matter of a choice rather than being of a systematic nature. One is yet to hear of the final outcome of the investigations into the stock market boom of 2003-04 and the role of participatory notes and hedge

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12 INDIA, Department of Company Affairs, *Report of the Committee on Corporate Audit and Governance*, Chairman: Naresh Chandra, 2002.

funds.[13] SEBI has even refrained from making public in full its observations on the compliance with the corporate governance code. One can only get some glimpses of this from the Narayana Murthy Committee Report. One also wonders about the rationale behind the confidentiality maintained by the regulator in case of daily deals, especially of FIIs. While certain sections of the trading community know about the goings on, the ordinary investor is wiser only after it is reported by the press the next day or some days later. By that time, the real gains would already have been made or the damage for some would have been controlled.

There needs to be clarity of objectives. Is the objective to provide capital cheaply to enterprises? Is it to enable international capital flows? Is it to let the savings of the household sector flow directly into the market and thereby let the fruits of enterprise be distributed over wider sections of the population? In the name of creating successful enterprises (and possibly protecting the Indian enterprises from takeovers) should one allow an unbridled growth of concentration of economic power? These issues are far beyond the scope of the regulator and its *ad hoc* committees. The government has to take the responsibility and the initiative to clarify them and to set guidelines.

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[13] See for detailed discussion on this: K.S. Chalapati Rao, "Stock Market", an article published in *Alternative Economic Survey, India: Magnifying Mal-Development*, Zed Books & Rainbow Publishers, 2004.