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HERE LIES
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PLUS REGULAR FEATURES
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MEGA ISSUE GUIDELINES

An appraisal

As a sequel to the hue and cry raised in financial circles against the misuse, actual and possible, of the astronomical sums raised by some companies through mega-sized issues of convertible debentures, the government has announced certain guidelines which are to apply to issues of Rs.50 crore or more. The guidelines stipulate (a) monitoring end-use of funds received from public till their deployment in the proposed activities; (b) regulating the flow of funds into only those activities specifically mentioned to be undertaken; (c) stipulation of the extent of amount that can be called at one point of time, and (d) specifying that a subsequent call of money, following an earlier call, can be made only if the monitoring agency - that is the financial institutions - is satisfied about the actual end-use of funds raised, vis-a-vis the intended use.

LIQUIDITY VS PROFITABILITY

The monitoring of liquid funds from point of arrival in the company till deployment is an important and delicate control activity. The administration of such liquid funds has a socio-economic dimension. As soon as cash is received, the liquidity position of the company increases and unless adequate efforts are made to effectively deploy the surplus cash in the interim period, the profitability of the company may be adversely affected. It is a well known financial dictum that liquidity and profitability are at loggerheads. Hence, the need for caution in allowing surplus cash to lie idle or unproductively employed.

The motivation of the enterprise to overcome the surfeit situation in the interim transitory period is, therefore, understandable. However, the transaction which is initiated as a purely temporary proposal for parking surplus funds, may get extended beyond the necessary duration.

Hence the fears on the part of the government and the eventual scepticism of the investors when they come to know about the delayed flow of funds into the intended uses mentioned in the document related to the issue. The entire society, concerned with the respective issues as investors, have their interest at stake.

How large have been the sums raised at one stroke can be seen from the following details:

Larsen & Toubro raised Rs.820 crore in four instalments of Rs.75 per debenture against the face value of Rs.300 over a period of less than 12 months, each instalment being 25 per cent of the face value of the debenture.

Bindal Agro raised Rs.500 crore in three instalments of Rs.100 each against the face value of Rs.2,000 per debenture upto allotment and the balance Rs.100 or 50 per cent at the discretion of the company.

Apollo Tyres raised Rs.103 crore in two instalments of Rs.50 each against the face value of Rs.100 per debenture, each instalment calling 50 per cent of the face value.

Usha Rectifier wanted to raise Rs.700 crore through an issue of debentures of Rs.100 each. Of the face value, Rs.40 was payable upto allotment and the balance Rs.60 at the discretion of the company.

Essar Gujarat raised Rs.406 crore in two instalments of Rs.90 per debenture (face value Rs.180),
Each instalment calling 50 per cent of the face value.

CHANGES MADE

Thus, prior to the guidelines, the amount raised was in the region of Rs.2,500 crore with unmonitored frequencies. However, following the new guidelines, the amounts can be raised only on a predetermined instalment pattern - 25 per cent of the face value on application, another 25 per cent on allotment, and the remaining 50 per cent in at least two calls.

Further, the question of parking the amounts raised, big or small, in instruments of the entrepreneur’s choice just does not arise because the guidelines require that the funds so raised can be parked, if such parking is necessary only in prescribed investment outlets, and that the funds so parked have to be separated from the other financial assets of the issuing company at an early date before their deployment in the channels explicitly mentioned by the entrepreneur in his application.

This is a wise move in as much as while monitoring the movement of money it ensures a medicine, hopefully not very unfavourable, of return on the liquid resources enjoyed by the issuing company in the interim period. It would simultaneously prevent the company from being enticed or seduced by the attractive returns from temporary financial instruments. It is not untrue to say that the guideline in this regard almost directs companies to accept enlightened self-restraint with respect to investment of surplus cash.

Further, since the returns on these liquid resources in the interim period will not be unduly high, companies will be motivated to seek early release of the funds from these permitted avenues and get them flowed into the activities for which they have been raised. The first tab on the liquid resources in the interim period itself checks the motivation to prolong parking of funds in the financial assets intended to be held only temporarily.

The monitoring institutions are supposed to ensure that the funds are channelised only for the desired end purposes. A further brake on the tempting motivation to prolong parking of funds, in addition to the split in the amounts that can be raised, is the certification required for every call subsequent to the first call. This reduces the amount of funds available to the company in the form of excess cash in the transit period, from receipt to deployment at any point of time.

MARKET PRICE—RISE AND FALL

The profile of the market prices of the recent mega issues during junction points like ‘prior to the issue’, ‘at the time of issue’, and ‘post-issue’ speaks for itself. Investors are induced to part with their savings by making them believe that they can get something which is worth more at a very low price. After the investors fall a prey, that which was supposed to be worth more, is no longer so worthy. In fact, the worthlessness hovers just around the price paid by the investor.

Thus, in the case of L&T, Bindal Agro, Usha Rectifier and Essar, the investors were told fifteen days prior to the opening of the issue list that by paying Rs.50 (including premium of Rs.40) they would get a share worth Rs.102, Rs.116, and Rs.145 respectively. Again in the case of Essar Gujarat, the company offered a share whose market price was ruling around Rs.82 for Rs.40 (including premium of Rs.30). This almost amounted to...
telling the investor that by parting with a rupee today, at least twice the amount could be recovered in the none too distant future.

The investor, however, now finds that he paid Rs.50 for a share which is now worth much less - Rs.67 as against Rs.102 in the case of L&T, Rs.68 as against Rs.116 in the case of Bindal Agro, Rs.50 as against Rs.145 in the case of Usha Rectifier. In the case of Essar Gujarat, the investor has paid Rs.40 for a share which is quoted at Rs.46 as against Rs.82 earlier.

The short-term nature of the lucrative offer made and the attractive returns projected tend to be revealed only when prices eventually (sooner or later) tend to relate themselves to the intrinsic economic worth of a share. The hope of becoming wealthy soon lies belied and shattered. Invariably prices, at and before the launch of the issue are artificially stimulated and pegged up to the levels which just cannot be expected to sustain for itself ad infinitum. In fact, prices would like to relate themselves to the real performance of the company rather than keep shooting up as reflexes to mere buying stimuli.

**COST OF CAPITAL**

The above clearly shows how the innocent investor's hope of wealth accumulation through capital appreciation is frustrated. An incisive analysis of the outflow-inflow patterns for the debenture issues for the companies is more revealing. A substantial sum of the debenture issues has been mopped up through premia which are available to the company as 'gratis'.

For instance, L&T, Bindal Agro, Usha Rectifier and Essar will mop up premia of Rs.680 crore, Rs.400 crore, Rs.560 crore and Rs.316 crore respectively or nearly 80 per cent of the issue size. Of course, this is based on the assumption that the conversion rates prevailing for the announced parts will hold true for the unannounced part of the debenture. The investors are, therefore, giving free money to the company and in return they are being almost duped in terms of the eventually depressed market prices.

From the companies point of view, the gratis amount so mopped up reduces the burden of servicing the capital on revenue account, that is, interest payment and capital account or loan amortisation.

A substantial sum of the debenture issues has been mopped up through premia which are available to the company as ‘gratis’

The servicing is restricted to the non-convertible portion which has to be redeemed and to the converted equity which is entitled to partake in the prosperity of the company through dividend, bonus, rights issue and other benefits.

Because of the mopping up of sizeable amounts through premia, the cost of capital gets depressed and the internal rate of return based on the inflow-outflow pattern of the debenture issue from the company's view point, is not only low but in some cases, negative.

This low cost of capital on the one hand and "laissez faire" for funds parking in the interim period facilitate promise of excellent returns. Such operating excellence was used to trigger off favourable conversion equations following the maintenance of share prices at attractive, and many a times, at deceptive levels. While the question of raising astronomical sums, all at one stroke and deploying at will is now monitored through the guidelines, the question of abnormally low or even negative cost of capital still remains.

Unless the government machinery concerned with the fixation of share premium evolves a fair, objective and universally applicable formula, the ills haunting mopping up huge amounts as gratis and the concomitant low or negative cost of capital and dangerous corporate complacency will still remain.

**INVESTOR PROTECTION MEASURES**

Another control intended to be initiated by the government in this regard recently, deserves special mention. There is some thinking regarding further investor protection and the Finance Ministry also agrees with the same. The intended measures include:

1. Providing the choice of conversion to the investors unlike at present when the conversion is automatic.
2. Providing investors with a reasonable time, of about two months say, to take a decision - conversion or no conversion. The onus for conversion will, therefore, shift from the company to the investor.
3. Providing information relating to the conversion equation on a predetermined basis and dispensing with the suspense. The
investor, therefore, has all the inputs relevant for measuring the economic worthiness of the portfolio to be acquired.

Thus, the conversion itself, the timing and the rate is monitored, made known in advance to the investor and choice of a decision, if any, rests with him. This healthy development, when it becomes a guideline, will have serious ramifications.

The massive diversion and misuse of funds for "operation price support" will be controlled because it will not be possible for companies then to indulge in price manipulation and artificial pegging for long periods of time. Sufficient time interval for decision-making for the investor and the trickle with which decisions will sporadically pour in over the permitted time period will render it difficult for companies to gauge the impending outcome and investor behaviour.

Rather than the investor hazard ing the guess game, companies themselves will have to either hazard it or resort to fair dealings. This is the raison d'être of the control process initiated, so far through the guidelines and in future through the intended investor protection measures.

The new guidelines have been necessitated because 'operation mega' has belied many expectations - fair deal to investors; the expectations of non-manipulative prices and flow of funds only

into channels desired at the time of application.

Along with the additional investor protection measures, the said guidelines should be in a position to introduce healthy tendencies in the capital market and also amongst segments and parties providing and partaking the loanable funds awaiting investment.

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