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Govt’s plan to increase listed cos’ public shareholding to 35% to improve corporate governance

The move will increase the institutional shareholding in a firm, while positively impacting retail and international investors’ participation in Indian stock market

By Ranjitha Ajay

Indian listed companies have higher proportion of promoter ownership indicating dominance of promoters in firm’s shareholding. The conflict arising between majority and minority shareholders generally results from concentration of ownership specifically in the hands of promoters.

The recent proposal from finance minister Nirmala Sitharaman to increase the minimum level of public shareholding from current 25% to 35% in listed firms is a welcome step to improve price discovery of stocks and corporate governance mechanism. This also results in increase in institutional shareholding in a firm. Also, it’s a positive step towards increasing retail and international investors’ participation in Indian stock market.

This norm may enhance stock liquidity due to increased stock trading volume. The present proposal is an opportune moment to reduce government stake in public sector undertakings that also aid in achieving disinvestment target and raise funding to reduce fiscal deficit.

The recent trend of promoter holding in CNX 500 firms show that on an average promoters hold 55.65% of shares indicating dismally low public float in top listed firms. Of the total, 46% are Indian promoters and remaining 10% are held by foreign promoters. Further data analysis reveals that around 164 firms have promoter holding of more than 65% (on an average promoter holding of 74%). This shows that these firms need to offload their share to reduce the promoter ownership (less than or equal to 65%) and increase public holding. Indian promoter ownership is more than 65% in 114 firms among top 500 firms. 28 firms in this sample have foreign ownership above 65%. These firms need to formulate strategies to bring down their concentrated ownership pattern in timely manner.

Promoters may perceive the current proposal of increasing public float from current 25% to 35% will reduce their controlling stake in the firm. Hence listed firms with very high level of promoter’s stake prefer to delist (promoters acquire shares of the company they founded) rather than diluting their control through share offloading. This ensures promoter control is retained in the firm. Although delisting allows promoters not to adhere to current listing norms, not all companies could afford to do so. Firms with higher growth prospects and in dire need of additional financing may not prefer delisting. Young and growing firms may find the present listing norm to be stringent and therefore may forego listing in stock exchange to raise long term finance. They need strong presence of promoter founders to make strategic investment decisions and may not prefer diluting promoter stake by listing.

Increase in share ownership of public is good news for minority shareholders as this will result in their growing participation in passing resolution during board meetings. Higher promoter ownership helps promoters to pass any special resolution without much opposition. Such dominance leads to implementation of firm level decisions which are not favourable to create value for minority shareholders. However present listing rule will enable minority shareholders to voice their concern through increased voting rights. Thus increase in public shareholding creates a conducive environment for improved corporate governance.

Promoters with higher ownership stake influence internal decision making in a firm. They motivate managers to project smooth earnings to avoid negative stock price reaction resulting in lower financial reporting quality. However, reduction in promoters shareholding may increase the quality of reported information and thereby reduces overvaluation of stocks. Better price discovery attracts large number of players in the capital market thereby increasing the depth and volume of stock trading.

Shifting or changing the present organizational shareholding pattern (as per current proposal) to the new one may not be a smooth and easy transformation. Regulators need to formulate specific time frame to implement the current listing norm taking into consideration present ownership pattern of the firm and their size in terms of market capitalization. There are several ways through which promoters can dilute their ownership namely institutional placement programme, rights issue, bonus issue, follow on public offer etc. Firms need to be cognizant of the impact of each of the said methods of lowering promoter stake on stock price. High price impact (specifically negative) may be detrimental to the overall market value of firm.

Securities and Exchange Board of India (SEBI) needs to formulate various strategies to implement the proposal of minimum public shareholdings taking into account the pros and cons of the same. Firms need to be given a time frame (depending upon their shareholding and market capitalization) to achieve a certain threshold of shareholding each year so that firms can finally adhere to targeted level of 35% or more public float in coming years.

Increase in the average proportion of free float market capitalization elevate India's weight in MSCI index. This would attract large number of foreign investors to Indian equity market. Foreign investors prefer equity market with higher free float as it improves stock liquidity and reduces stock price volatility due to reduction in bulk buying and selling.

Increase in public float has many benefits though regulators may face several hurdles to implement the same. To enhance the efficiency of equity market and increase the trading activity (stock liquidity) market regulators need to ensure the proposal is implemented slowly and steadily.

All the stakeholders need to be made aware of the benefits of the present proposal and proper documentation is needed for timely implementation. Capital market need to be accessible to all investors such large, retail and foreign. Let us hope that SEBI would implement the proposal with much enthusiasm and take the Indian equity market to the next level with enhanced global presence and retail attraction.

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