From 75% to 2.5% in three decades

The small investor has been edged out of the primary market - systematically

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After a lull of over two years, the primary market came out of its slumber in early-2003. Between January 2003 and June 2005, companies raised Rs 42,879 crore through public issues. In calendar 2004 alone, they raised Rs 30,511 crore, the combined mobilisation of the preceding nine years. While these numbers suggest a market teeming with investors, the reality is that the small investor is still missing from the action.

Of the Rs.42,879 crore raised, since January 2003, Rs 41,288 crore was through book-built issues. Who benefited? The moneybags. What did the small investor get? Just Rs 9,174 crore, or 22 per cent. It's not because he didn't have the money or was unwilling. It's because policies and processes prevented him from participating -- and still do so. Ironical, when policymakers talk of how to bring small investors to the market. Essentially, there are three problems in the market: confidence, policies and processes.

Confidence

A series of unresolved, unpunished scams between 1992 and 2001 shattered investor confidence. Weak entry norms for issuers and an inadequately regulated market enabled thousands of companies to "loot and scoot", exposing small investors to their unscrupulous ways.

In spite of a growth in the household savings rate, the share of household investments in equity/debentures has been steadily falling -- from 23.3 per cent in 1991-92 to 1.4 per cent in 2003-04. This issue of confidence is now being addressed, in some manner, through high-quality issues. What we still lack is meting out swift and adequate punishment to the offenders and compensating investors.

Policies

Policy changes over the years have played a major role in edging out small investors from the market. For instance, in the last three decades, the concept of public listed companies has been hugely diluted. Public offer as a percentage of a company's equity capital has been brought down from 75 per cent to 25 per cent (in some cases, even to 10 per cent). In the January 2003 to June 2005 period, the Rs 42,879 crore offered as public issues works out to just 14 per cent of the total issuing companies' capital of Rs 3,06,909 crore.

It gets worse for small investors in book-built issues, where only 25 per cent of the issue is reserved for him (as against 50 per cent in fixed-priced issues). So, if a company offloads 25 per cent of its capital, the small investor gets only 6.25 per cent of its capital (25 per cent of 25 per cent); if it offloads 10 per cent, the small investor gets only 2.5 per cent.

Between January 2003 to June 2005, only 3 per cent of the total capital got allocated to small investors. When there were no FIIs, almost the entire public offer was subscribed to by small investors. Even the government, which has been the dominant issuer in the primary market, raising 65 per cent of the total amount, has been unkind to the small investor, giving out peanuts.

Recently, after much persuasion, the reservation for small investors was increased from 25 per cent to 35 per cent. But this means little. From 2.5 per cent, the retail allocation will increase to 3.5 per cent. The various grounds on which the low reservation for small investors has been justified, including lack of depth, are substantially bogus.

Clearly, the small allocation to small investors has been a huge hindrance to expanding the investor base. A small reserved portion also leads to huge oversubscriptions, leading either to rejection of applications or very small allotments, both of which act as a disincentive to small investors to apply in public offerings. The three Rs 5,000 crore - plus offerings last year- ONGC, NTPC and TCS - attracted only 0.57 million, 1.4 million and 1.2 million investors, respectively. (In 1992, the Rs 217 crore issue of Mangalore Refineries drew 4.4 million applications).

Processes

The systemic advances in the secondary market haven't rubbed on the primary market. Some of the processes are archaic and investor-unfriendly. The application form itself is daunting. Not only is an investor prone to making mistakes, leading to rejection of his application, the multiple entry of elaborate data leads to costs, errors, delays.

Worse, while institutional investors can apply for shares without putting in a rupee upfront, the small investor has to shell out the full amount at the time of application. Further, it is still not mandatory for companies to send refunds through ECS. Since companies like to keep the float longer, they still prefer to use the antiquated system of refund orders, with the result that credit of shares takes place much earlier than credit of a refund.

The way forward

For any expansion of the investor base, the primary market will have to play a pivotal role. Economies grow when household savings get invested in public offerings (which, typically, fund new projects and expansions), rather than in the secondary market (which doesn't result in capital formation).

Critics would cite the excesses of the nineties to justify exclusion of the small investors, but because of new entry norms and systemic advances, the quality of issues has improved significantly. In 2004, 99 per cent of the total amount raised was by companies with a track record, almost making it a market for seasoned offerings. The average size of the 34 issues was Rs 897 crore, with three issues exceeding Rs 5,000 crore. In 1995, by comparison, 1,444 companies raised Rs 13,887 crore, or an average offer size of just Rs 9.7 crore.

There are more than Rs 70,000 crore of public offerings presently lined up. Fortunately, this pipeline is again dominated by large issues, from established companies and promoters, including several PSUs. Enlarging the size/percentage of capital offerings, and earmarking a greater allocation to the small investor, will expand the investor base and channelise household savings into the capital market. About time regulators and policymakers realised that small can be beautiful.