Vested interests, real interest

Why should bankers and issuers pocket the interest on the application money? Since that money has come from you, the interest too should come to you

The total public issue float this year was Rs 1,91,863 crore –eight times the combined issue size. Interest for 21 days at 6 per cent: Rs 641 crore

Prithvi Haldea

Last year, after much prodding, market regulator Sebi (Securities and Exchange Board of India) asked companies to give investors the option to receive refunds by ECS, in addition to the existing practice of physical cheques by mail. The ECS route not only eliminates problems related to post (refunds getting delayed, worse getting lost), investors also get their refunds faster -- on the same date the shares are allotted.

This move had been opposed by several constituencies with vested interests, who wanted the issue proceeds -- called 'float' -- to stay with them for as long as possible. By doing so, issuers and bankers could earn interest on the float for a longer period of time. In times when issues are oversubscribed heavily, they benefit hugely, as the interest works out to a sizeable sum. By allowing the ECS option, some of those undeserving gains going the way of bankers and issuers have stopped. However, they are still pocketing a huge amount of interest, which also needs to be tackled.

Take it from issuers…

Although refunds are now made on the same date as the allotment through the ECS route, the issue process still spreads out over nearly 21 days. During this period, the subscriptions -- more importantly, the oversubscriptions -- stay with the bankers to the issue. In public issues, retail investors and non-institutional buyers have to deposit 100 per cent of the application money upfront. Since August 2005, even qualified institutional buyers (QIBs) have had to give 10 per cent of the application amount as margin.

With almost all issues getting oversubscribed, and some very heavily, this leads to a large float between the date of closing and the date of refund. This financial year, between 1 April 2006 and 28 February 2007, the total float was Rs 1,91,863 crore, against the total issue size of Rs 24,533 crore. Naturally, the interest on it would be a significant amount. Based on conservative estimates -- the float earning an interest of 6 per cent per annum (rates have gone up since) and assuming all refunds are enchased on the date of listing -- the interest on the float works out to a sizeable Rs 641 crore. The interest on the float in 2005-06 would have been even higher, as over-subscriptions were higher.

Let's take individual issues. In the list of top 10 issues of 2006-07 by money collected, the interest earned based on the two above-mentioned estimates varied between Rs 15.9 crore (Sun TV) and Rs 137.5 crore (Reliance Petroleum). At least 10 issuers would have earned as much as 5-11 per cent of the issue amount through interest on the float alone (See table: Money for nothing).

…and give it to investors

The interest on the float is earned by collecting bankers. However, in practice, they share it with issuers. While some amounts are directly passed on to issuers, in some cases, the collecting bankers keep part of it from which they pay out some of the issue-related expenses. Rightfully, though, the interest on the float should belong to neither the bankers nor the issuers. It should belong to investors, as it is being earned on their application monies; no one else should have any right on it.

At Rs 641 crore in just 11 months, we are talking about a big amount. To put this figure in perspective, the Investor Education & Protection Fund run by a government ministry, after decades of existence, has been able to build a corpus of only about Rs 400 crore.

Here's a proposal: make it mandatory for bankers to remit this interest amount to Sebi, which then credits it to its newly-created Investor Protection Fund. Since the money belongs to investors, use it for their good, towards investor education and protection programmes. In fact, this interest amount would exceed the fines and penalties this Fund would otherwise depend on. Although each applicant may not be the direct beneficiary of this policy, the investing community as a whole will benefit. A similar provision may also be made for rights issues.

Given the recent slump in the market, the number of issues coming to the market might fall; even the ones that do come may not be heavily oversubscribed. Still, that shouldn't deter Sebi from bringing this change, as this policy would at least be in place when the next round of public issues hit the market. In addition, going forward, processes are likely to change or be made more efficient, leading to a reduction in the period between the date of closing of an issue and the date of allotment. Even for such reduced periods, the amount that would accrue to the Investor Protection Fund would be meaningful.

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Money for nothing

When issues are heavily oversubscribed, the interest earned by bankers and issuers on the money collected is sizeable -- and a freebie. In 2006-07, these 10 issuers would have raked in 5 per cent or more of the issue size from just the interest component.

	Issue size (Rs cr)	Float (Rs cr)	Interest* (Rs cr)	As % of issue size
Sobha Developers	569.2	18,671.7	64.5	11.3
Global Broadcast News	105.0	3,243.5	11.2	10.7
MindTree Consulting	237.7	6,518.2	22.5	9.5
Tech Mahindra	465.2	9,262.0	36.5	7.9
Development Credit Bank	185.9	3,530.0	12.2	6.6
Akruti Nirman	361.8	6,449.7	20.1	5.6
Action Construction Equipment	59.8	1,059.4	3.3	5.5
Parsvnath Developers	1,089.8	18,148.8	59.7	5.5
Cinemax India	138.3	2,074.9	7.2	5.2
Reliance Petroleum	2,700.0	39,824.3	137.5	5.1

* At 6% a year