Taking Stock
Playing in the Indian Capital Markets

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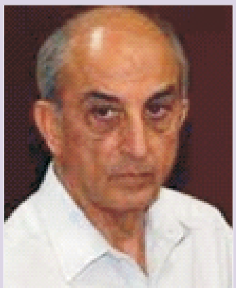
Foreword



The year 1992 was in some ways a watershed year for Indian capital markets—establishment of an independent regulatory authority, the Securities and Exchange Board of India (SEBI), coincided with the abolishment of the restrictive Controller of Capital Issues (CCI), signalling a marked shift in administrative approach to regulation of Indian capital.

In the following decade, as SEBI grew stronger, the capital market also matured. There was widespread adoption of technology such as demat accounts, setting up of online trading platforms, developing futures and options and robust indices like SENSEX and NIFTY. Along with growth of capital markets, there have also been frequent stock market scams such as the spectacular Harshad Mehta & Ketan Parekh incidents and almost-regular cases of circular trading, round tripping, IPO mis-valuations, etc. And along with the growth of scams, SEBI's adjudication process has also matured to deal with them, even if not entirely satisfactorily.

SEBI has been instrumental in instituting a basic level of corporate governance among listed companies through the listing agreement (Clause 49) to an extent that it has become a benchmark governance document even among non-listed companies and other entities. The level of adherence to clause 49 (92% companies as of March 2012) while no guarantee of the quality, at least ensures that formal governance mechanisms are in place.

Similarly, SEBI's new 2012 requirement from listed companies to report on sustainability parameters through Business Responsibility Reports is expected to ensure a basic level of corporate attention to this important subject which currently is not in the ownership domain of any regulatory authority.

However, SEBI must demonstrate transparency in its working in the same measure that it expects from its constituents; arbitrariness in adjudication process and consent orders being two major areas of concern.

In the final analysis, it is testimony to SEBI's solid work of building the confidence of the retail investor in the Indian capital market that even radio jockeys provide regular updates of movement in SENSEX and NIFTY in between airing popular music.

Vijay Kumar Shungl[u]
(Former Comptroller & Auditor General of India)

Executive Summary

It was in the 1870s, on the now-well-known 'Dalal Street' that the Indian Capital Market first took concrete shape. There has been no looking back since then; several milestones have been crossed along the way. In 1991 the liberal-market reforms fundamentally changed the way of conducting business in India, leading to renewed interest in the capital markets. The legislative framework of the country has been moving towards developing stronger, dependable and more participative/wider capital markets in India; as a result, they witnessed significant growth in this period. There is also a flip side to the story: the increasing number of scams and volatility in the market during this period. With the help of market regulators like SEBI and supportive legislation, a concerted attempt is being made to deliver clean markets. This paper seeks to take stock of the current situation; to see the kind of impact some of these activities have had on the market. Such an attempt has to be, by its very nature, a matter of vast scope; this paper is an attempt to approach the subject from certain perspectives, thereby contribute to the understanding of the current scenario. Following are the key findings:

Promoters' Stake in Indian Economy

- Promoters' holding is one of the key determinants of firm value.
- Literature suggests a non-linear relationship between these two indicating that somewhere in the lifespan of the firm, as the promoters' holding increases, s/he may indulge in non-value maximizing activities.
- Analysis of BSE 500 companies (over three years) shows that on an average their stake has been around 60%.

Pledging of Shares by Promoters

- Pledging of shares by a promoter lead him/her to manipulate stock prices, to keep them at an artificial level, to maintain margin money or avert a hostile takeover (as exemplified in the case of Satyam Computer Services Limited recently).
- Analysis of BSE 500 companies shows that promoters have pledged shares in about 35% of them. As far as the extent of pledging goes, on an average it is about 30 % of the promoters' shares.
- Pledging has also increased in the years 2009-10 (44%) and 2010-11 (27%).
- Pledging is believed to be one of the precursors of volatility in the market.
- Our analysis shows that on an average 75% of the companies with pledged shares have also exhibited share price volatility greater than 10%.
- About 87% of the companies with pledged promoters' shares display more volatility than BSE Sensex or BSE 200 index.
- On an average in 70% of the companies had share price volatility greater than 10%, there was in fact movement in pledged shares; and in about 68% of these, the movement in pledged shares was greater than 10%.
- The analysis has found beyond reasonable doubt a coincidence between instances of pledged shares and share price volatility.

Study of Mega Issues

- Several studies have found distinct evidence of manipulation in IPO pricing, in an attempt to stabilize prices at a certain level.
- Our analysis of mega issues (size of Rs 300 cr. or more), shows that in almost 41% of the cases across years, the opening price itself was at a discount to the offer price, suggestive of off-market operations.
- Most of the companies are not able to retain the day's

- opening price during day's trading: nearly 74% of the issues closed at a price lower than the opening price.
- Further analysis of price movements during the subsequent eight months shows that while on an average 29% of the issues trade at discount by the end of the first month, as many as 48% trade at a discount from the third month onwards and this percentage becomes more than 50% by the end of the seventh month.
- IPO grading an attempt to simplify the task of evaluating complex IPO process does not seem to be a good indicator of future performance. In 2010-11 half of the issues graded 'five' and almost 90% of those graded 'four' had negative returns.

Informed Trading

- We analysed instances of insider trading disclosed to BSE. The preceding and succeeding period of 'the insider trade' (15 days before and after) was compared with 'the normal period' (30 days before the beginning of the preceding period).
- Greater share price volatility and turnover were observed in both the periods preceding and succeeding the day of the insider trade.
- A fall in price accompanied by 5-10% intra-day swing was observed in the share price.

SEBI: Market Regulation

- Corporate Governance Norms: Analysis of company submissions of compliance report to SEBI for the quarter ended on 30th June 2011 shows that seventy per cent companies comply with prescribed norms.
- Analysis of the Appeals Process of SEBI (100 appeals studied) shows that in 35% of the cases it took more than 4 years for SEBI to appoint an AO, the first level authority in the process. In 32% of the cases the show-cause notice was issued after six months.
- In 40% cases it took more than 2 years to complete proceedings.
- In 56% cases it took more than 5 years to pass an order.
- There seems to be no prescribed standard time with respect to the notice, suggesting arbitrariness in the process.

Analysis of Consent Orders

- Consent order allows compounding of offence, whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution.
- In the analysis of about 100 consent orders, we found that 53 % of the cases were resolved within 180 days; another 28% were wrapped up in 180-360 days. Consent Orders do positively expedite the resolution of old cases.
- But about 24% of the cases settled through consent orders were less than twelve months old where SEBI could have taken the normal route. There are no clear guidelines regarding the type of cases that may be settled through the consent order route, leaving considerable room for discretion.
- In 58% of the cases penalty levied is less than Rs 3 lacs, possibly indicating revenue loss to SEBI, perhaps not a stringent enough application of the provisions leading to a weaker monetary deterrent for lapses.
- Moreover no correlation could be found between ageing of cases and the amount of penalty, suggesting some subjectivity in its application.

On January 2001, Sensex hovered around 4000. In the following decade it witnessed about a fourfold rise: in the last few years, ranging between 15000 and 20000. This is the decade in which the Indian growth story established itself; the Indian businesses gained increasing access to global capital; while the FIIs, attracted by the buoyancy in India, increased their participation and exposure to the Indian Capital Markets. It must have been a challenge for SEBI to not only manage such a market, but keep it free of all dubious operations and at the cutting edge of global best practices. There is still some distance to go before the Indian Capital Markets can be declared truly mature, transparent and rule-based; however, one can safely assume they are on their way.

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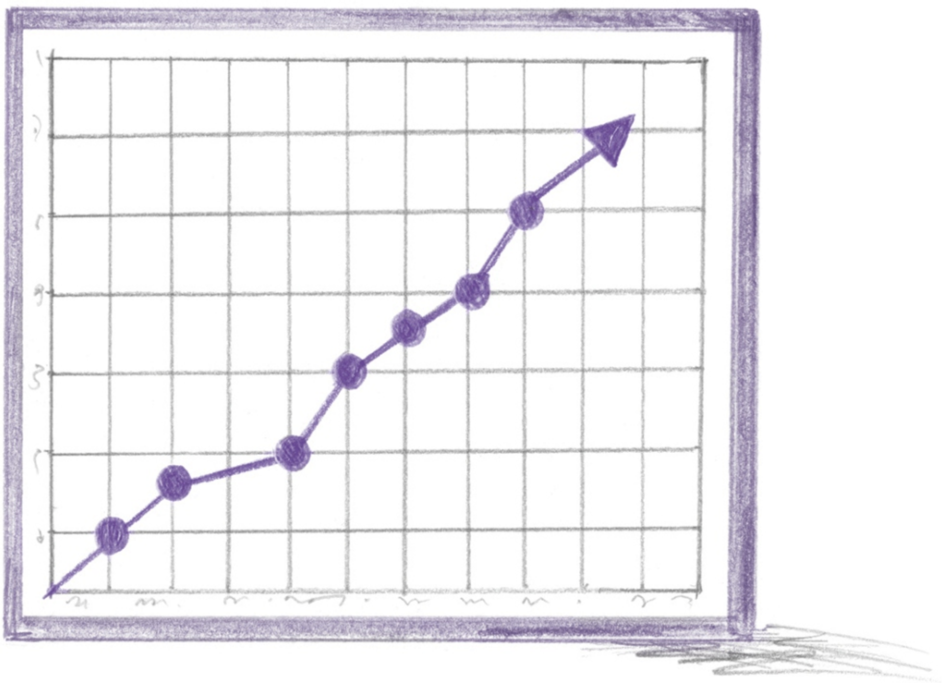
01

OVERVIEW OF INDIAN CAPITAL MARKETS



Overview of Indian Capital Markets

The Roots: Quick Recap

The first instance of an organised market in stocks, in India, can be traced back to 1870s; by when, the securities market had stabilised enough for brokers to gather together in a sort of marketplace on a street called 'Dalal Street', in Bombay (now Mumbai). In 1875, The Native Share and Stock Brokers Association was formally established, also known as the Bombay Stock Exchange. It is the oldest stock exchange in Asia.

As the economy consolidated under the British Raj, several stock exchanges opened across the country one after the other. Post independence their fortunes fluctuated as many merged, re-organised or shut down altogether. Around 21 stock exchanges are registered and recognised under the Securities Contracts (Regulation) Act, 1956. However, today only twonamely, Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) have active trading in large volumes and may be considered representative of Indian securities market.

The Bombay Stock Exchange developed the BSE Sensex in 1986, an indicator to measure overall performance of the exchange. Historically an open-cry floor trading exchange, the Bombay Stock Exchange switched to an electronic trading system in 1995. In 2000 the BSE, based on this index, opened its derivatives market in Sensex futures contracts. The development of Sensex options along with equity derivatives followed in 2001 and 2002, expanding the BSE's trading platform.

Capital markets reforms in India and the launch of the Securities and Exchange Board of India (SEBI) accelerated the formation of the second Indian stock exchange called the National Stock Exchange (NSE) in 1992. Within a few years of its existence, NSE has become the largest stock exchange in India. Three segments of the NSE trading platform were established one after another. The Wholesale Debt Market (WDM) commenced operations in June 1994 and the Capital Markets (CM) segment was opened at the end of 1994. Finally the Futures and Options segment began operating in 2000.

Deepening of Markets: Beginnings of Retail (investor) Participation

Retail investors began participating in the stock markets in a small way with the dilution of the FERA in 1978. Multinational companies with operations in India were forced to reduce their foreign share- holding below a certain percentage, which led to a compulsory sale of shares or issuance of fresh stock. Indian investors who applied for these shares realised windfall gains, because those days share issue price could not be decided freely and the formula for pricing was very conservative.

The next big boom and mass participation by retail investors happened in 1980, with the entry of Dhirubhai Ambani-promoted Reliance. Prime Minister V.P. Singh's fiscal budget in 1984 removed estate duty and reduced taxes leading to new issues and several new companies in 1985. Manmohan Singh (as Finance Minister) introduced liberal-market reforms in 1991, completely transforming the way business was conducted. This led to a resurgence of interest in the capital markets, only to be deflated by the Harshad Mehta scam in 1992. The end-1990s witnessed the Ketan Parekh debacle and also the advent of information, communication and entertainment companies. This period coincided with the dotcom bubble in the US, followed by a melt-down in software stocks in early 2000. Subsequent governments continued the liberalization and reform process: opening up the economy, lifting taxes on long-term gains and introducing early 2000. Subsequent governments continued the liberalization and reform process: opening up the economy, lifting taxes on long-term gains and introducing short-term turnover tax to encourage small investors to redirect their savings into stocks.

In the last few years, the introduction of the Fraudulent Trade Practices Act, the Prevention of Insider Trading Act and the Takeover Code and Corporate Governance Norms has made the Indian Capital markets attractive to foreign institutional investors. All in all, this has meant impressive growth in the Indian capital markets as borne out by the table 1.1

Table 1.1: Growth in Indian Capital Markets since Liberalisation (2000-2010)

Parameters	CAGR %*
Resource mobilisation in Primary Markets	17
Resource mobilisation through Euro Issues	44
All-India Market Capitalisation	23
All-India Equity Market Turnover*	20
All-India Equity Derivatives turnover	132
Assets under Management of Mutual Funds	19
Net Investments by Foreign Institutional Investors	31
Net Investments by Mutual Funds	54
Returns on Nifty 50	13

Source: http://www.nseindia.com/content/us/ismr_full2010.pdf
The review of Indian Securities market done by National Stock Exchange (NSE), volume XIII
Note: * 2000-01 2009-10

Current State: Types of Securities Markets and their Regulation

India is evolving into one of the most sophisticated trading destinations internationally. It has a long history of both the debt and the equity markets. Within equity, India has a fairly developed primary, secondary and derivatives market. Fresh issue of shares and other securities are conducted through the primary market. Investors can also buy/ sell securities in the secondary market. Trading is carried out through intermediaries on the stock exchange under the prescribed regulatory framework. Derivative trading in India is allowed in index futures, stock futures, index options and stock options.

In the recent years, India has seen several scams. The regulators haven't lagged behind. Many new legislations, along with the older ones, are in place to regulate the market. Prominent among them are:

- SEBI Act, 1992
- Companies Act, 1956
- Securities Contract (Regulation) Act, 1956
- Depository Act, 1996
- Prevention of Money Laundering Act, 2002

Securities markets are subject to varying degrees of regulation all over the world, because they involve vast sums of money critical to the economy; integrity is a key element in its functioning. Even so, scams occur with alarming regularity, leaving destruction in their wake. This is borne out by the investigations undertaken by Securities and Exchange Board of India (SEBI) as below:

Figure 1.1: Nature of Investigations Taken and Completed by SEBI (%)

Data Source: SEBI Annual Reports www.sebi.gov.in

SEBI, ever since its inception has effected considerable change in the Indian capital markets. More specifically, it has worked hard to develop and succeeded reasonably in increasing:

- Market Capitlization
- Number of listed firms
- Trading volumes and turnover in all sections of the market

There is an ever growing network of intermediaries instrumental in market formation. India has a fairly sophisticated new issuance market with a framework of regulations and procedures that would match the best in the world.[1] Yet it is also a market that has been constantly marred by scams every now and then.

Manipulation and rigging of price, and insider trading have been the proverbial "thorn in the flesh" for the regulator. Market surveillance plays a significant role in proper functioning of the markets. It has been and is expected to be one of the key inputs from SEBI into the process of development of the Indian Capital Markets.

Market surveillance plays a significant role in proper functioning of the markets. It has been and is expected to be one of the key inputs from SEBI into the process of development of the Indian Capital Markets.

Later, the paper delves deeper into the effectiveness of the specific measures undertaken by SEBI. From this point on the paper will attempt to evaluate if the capital markets which have come to play an increasingly significant role in resource mobilization in the country in the last decade are running effectively and efficiently enough, to fulfil their essential role.

The Organization of the Paper:

Part 1- deals with the promoters' stake in Indian capital markets, extent of pledging of such promoters' stake and the price volatility as a result of such pledging. The study uses volatility as a proxy for market manipulation by promoters and investigates if pledging of promoters' stake increases the chances of manipulation thereby the resultant instability in markets

Part 2 - looks at the price discovery process in the primary market, using mega issues as the base, to see if there are possible price manipulations.

Part 3 - looks at share price manipulation in the secondary market through informed trading. Insider trading is difficult to catch except with the most sophisticated surveillance mechanisms. The study analyses informed trading to examine whether there is sufficient reason to believe that there is price manipulation in secondary markets.

Part 4 - looks at the role of SEBI as the market regulator and examines the effectiveness of its adjudication process, particularly the practice of consent orders as a means of settling disputes.

[1] Sabarinathan G.SEBI's regulation of the Indian securities market: a critical review of the major developments. *Vikalpa* 2010;35(4):13-26.

02

PROMOTERS' STAKE AND IMPACT ON THE INDIAN ECONOMY

Promoters' Stake and Impact on the Indian Economy

Fiduciaries of Companies

A promoter is a person who puts together a business, particularly a corporation and provides or arranges initial financing and management depth. He/she is in over-all control of the company and is instrumental in the formulation of the initial investment plan or programme, pursuant to which securities may be offered to the public. Promoters have a strong influence not only on the companies' fortunes, but also on the interest of various stakeholders.

He/she stands in a fiduciary relationship with other investors and the corporation itself. It is an integral part of their duties to conduct their activities in utmost good faith and with strictest honesty and candour. He/ she is legally charged with a duty to disclose any interest in any transaction with the corporation. Their role being creative, exacting and challenging, it is natural for them to desire a certain amount of latitude in discharging their duties. Recently, however, as the Indian economy has begun to mature and become more competitive, the instances of stretching this too far have also been on the rise. A recent report on dealings of private equity (PE) firms has brought to light how the promoters and the firms have run into rough weather as the PE firms demand premium for alleged instances of bribery, graft , corporate governance failure etc.[2]

The following sections examine the role of Indian promoters in terms of shareholding and control, followed by an in-depth analysis of the phenomenon of pledging of shares by promoters and, its links with stock volatility and return.

Promoters' shareholding

'Promoter Group' includes the promoter or an immediate relative of the promoter (i.e. spouse, parent, brother, sister or child of the person or of the spouse). In case the promoter is a company the following would be clubbed as well:

- a subsidiary or holding company of that company
- any company in which the promoter holds 10% or more of the equity capital or which holds 10% or more of the equity capital of the Promoter
- any company in which a group of individuals or companies or combinations thereof holds 20% or more of the equity capital.

Promoters' holding is one of the key determinants of firm value. In a study, Anirban Ghatak found a non-linear relationship between the two. The firm's value initially increases with increase in promoters' stake, and then somewhere in the middle it decreases due to focus on 'entrenchment and other non-value maximizing activities'. As the stake rises further, the promoters' interest once again gets aligned with the firm and works favourably for firm value. As per entrenchment hypothesis, more equity ownership by manager/insider may lead to lower financial performance. With larger stake they might not be inclined to maximizing firm profit but look to maximize their personal utility. The study also affirms "Firms having high promoters' holding have experienced several fraud cases like accounting fraud, wrong information to the market etc. impacting the firm's value. Where the ownership is diversified their performance has been found to be better".[3]

In this context it is important to know the extent of promoters' holdings in Indian companies. Analysis of the BSE 500 companies over a period of three years shows that promoters' holdings are around 60% (refer Table 2.1 below) enjoy as much as 75% to 100% voting rights while in another 46% promoters enjoy 50% to 75% of voting powers implying a near absolute control on the workings of the company (as in figure 2.1).

Table 2.1: Promoters' Shareholding Summary

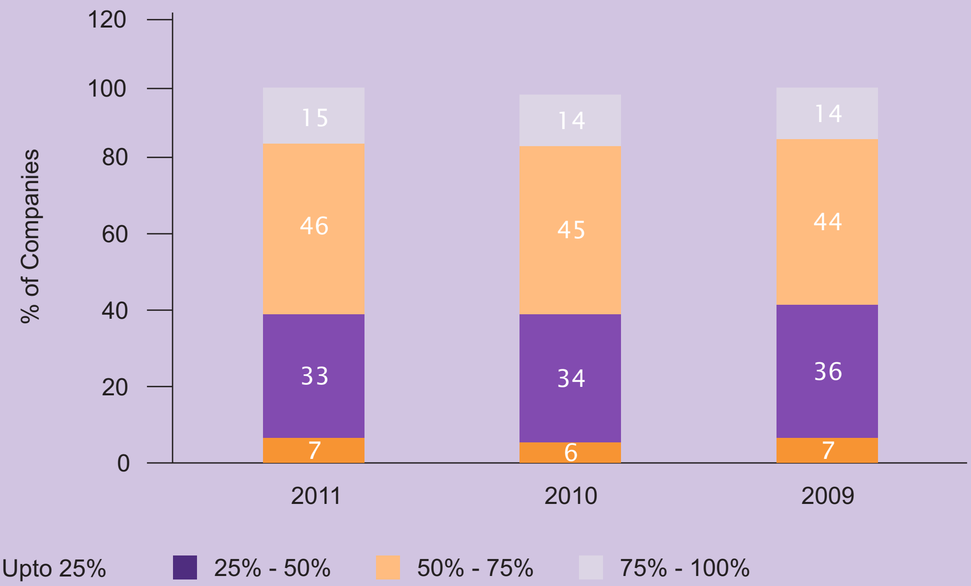
Particulars	Sep-11	Sep-10	Sep-09
No. of companies	500	490	459
Promoter's stake %*	60	60	62

Data Source: www.bseindia.com
Notes: *Percentage of the total shares of the company
In the group of BSE 500 companies as on September 2011, only 459 formed part of BSE 500 in September 2009 and 480 in September 2010. Therefore we have carried out the analysis for 459 companies that have consistently remained a part of BSE 500 for three years

As of March 2012, promoter's stake in BSE has increased to 63% in BSE 500 on an overall basis. Further dissection of the data reveals: In 15% of the sample the promoters

An analysis of shareholding in March 2012 affirms the above distribution, with promoters holding around 50% to 75% of the total shareholding in 47% of BSE 500.

Figure 2.1: Distribution of BSE 500 Companies According to Promoters' Shareholding



Data Source: www.bseindia.com

Promoters' equity is a measure of entrepreneurship and capital formation. Sometimes this spirit of entrepreneurship may be so strong that the interest of minority shareholders is accorded lower priority. Promoters might in certain situations resort to manipulative governance practices. A high promoters' stake leaves the minority shareholders with little say in the working of the company. Minority shareholders are further hit if a fraud is discovered in promoter-driven companies; the stock is frozen at lower circuit with only sell orders from investors and no willing buyers. The problem is further compounded if the stock is illiquid, which makes recovery of earlier stock price level difficult.

A high promoter stake may also indicate that a major portion of his/her wealth is tied in that equity. This may lead a promoter to pledge his shares to raise finances.

Pledging of Shares by Promoters

Section 172 of Indian Contract Act 1872 defines 'pledge' as 'the bailment of goods as a security for the payment of a debt or performance of a promise'. When promoters commit the shares of the company that they own as collateral for debt or borrowings, this pledge is called promoters" "pledged shares". The debt may be taken either as primary or secondary collateral for raising long or short term funds or even for personal needs. Promoters continue to enjoy the benefits of ownership (dividend, bonus shares, voting rights etc.) for the duration of the pledge.

As discovered earlier, promoters hold about 60% of stocks in BSE 500 companies. Hence the promoters could be in a position to influence the movement of market prices if the need arises. It is, therefore, reasonable for markets to monitor the status of promoters' holdings. SEBI, the market regulator, requires that a promoter disclose details of his/her pledged shares within seven days of creating the pledge to the company. Likewise, the company who receives such information from its promoters has to disclose it to the stock exchange within seven days and at the end of every quarter. Where pledging is done in parcels, the aggregate of all pledged shares must be disclosed if it exceeds 25000 shares or 1% of voting rights, whichever is lower.

This information is important to investors because the reasons offered for pledging shares might just be a cover. For instance, the company may not have adequate security to offer, leading the lender to seek the promoter's stock as additional collateral and means of personal guarantee. In other words, the company may be running short of cash and the pledge of shares may by symptomatic of a deteriorating financial condition. Or, stock may be pledged to raise money for personal or other business needs of the promoter that is not linked to the company, which could be a red flag. These could become potential flashpoints causing the market price to fluctuate as the lender demands either additional collateral or sells the existing collateral to recover dues. It is likely to cause share prices to fall further, leaving the retail investor with little time to get out of the market.

A significant fall-out of pledging in a declining market is the possible motivation for a promoter to manipulate stock prices, to keep them at an artificial level, to maintain margin money or avert a hostile takeover. This could be done through earnings management, falsifying financial information, circular or synchronised trading, or actively disseminating false information. This was exemplified in the case of Satyam Computer Services Limited in 2009, when the promoter B Raju had pledged his entire shareholding to the financiers. He was later found manipulating books of account by overstating the revenue receivable and cash balances by more than Rs 7,000 crores. As markets crashed following this shocking revelation, margin calls were made by the lenders resulting in heavy selling pressure in the stock which further pulled down the stock price. The stock prices crashed to Rs 11.50 in January 2009 from a high of Rs 544 in May 2008 and the wealth of some 300,000 shareholders was completely eroded.

Analysis of BSE 500 companies shows that promoters have pledged shares in about 35% of them. As far as the extent of pledging goes, on an average it's about 30 % of the promoters' shares. This average has increased to 35% in March 2012. Pledging has also increased in the years 2009-10 (44%) and 2010-11 (27%). *(See Table 2.2)*

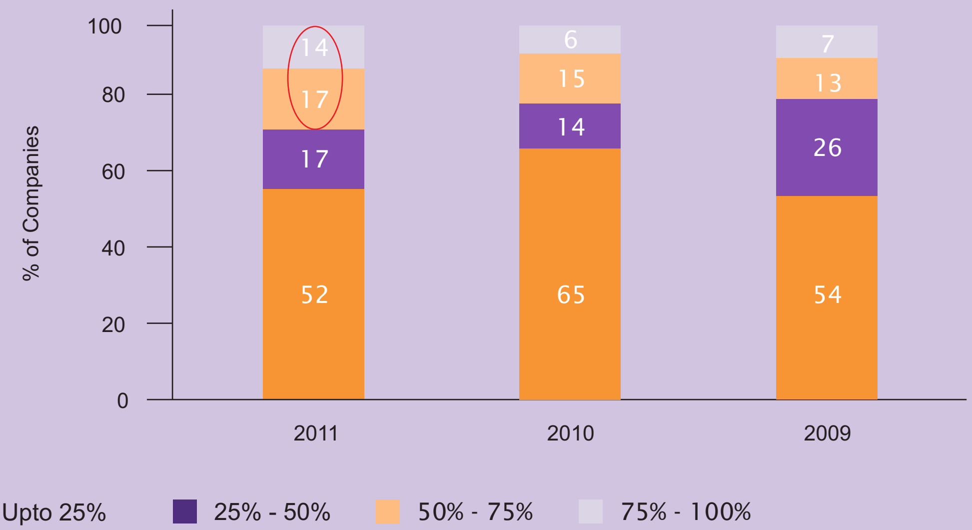
Table 2.2: Promoters' Pledged Shares in BSE 500

	Sep-11	Sep-10	Sep-09	Increase bet. 2010 and 2011	Increase bet. 2009 and 2010
Companies with pledged shares (no.)	174	172	164	1	5
Companies with pledged shares (%)	35	36	36		
Total Promoters' Shares	43,86,16, 57,122	38,74,30, 79,032	25,91,05, 16,480	13%	50%
Total no. of Pledged Shares	14,16,78, 08,440	11,12,96, 38,273	7,75,32, 06,493	27%	44%
Pledged shares to promoters' shares (%)	32	29	30		

Data Source: www.bseindia.com
Note: In the group of BSE 500 companies as on September 2011, only 459 formed part of BSE 500 in September 2009 and 480 in September 2010. Therefore we have carried out the analysis for 459 companies that have consistently remained a part of BSE 500 for three years. As of March 2012, 35% of BSE 500 had instances of pledging of promoters shares.

Further analysis of the ownership and pledging pattern reveals that in2011, in 30 % of the cases the pledged shares account for more than 50% of the promoter's shareholding, which may be a cause for concern (please see Fig.2.2). **A similar situation exists in March 2012, in 31% of the cases pledged shares account for more than 50% of promoter's shareholding.**

Figure 2.2: Breakdown of Promoters' Pledging in BSE 500 Companies



Data Source: www.bseindia.com

In the BSE 500 sample both the promoters' shareholding and extent of pledging is quite high. This could expose the stock market to high price volatility, manipulation etc., creating all manner of instability in the system. It becomes all the more probable given the fact that in nearly one third of the BSE 200 sample the pledging is more than 25% of the promoters' holding. According to a report by Crisil Research, promoters of 31% of the 1,214 listed companies and with a market capitalisation of Rs100 crore or more, have pledged substantial portion of their shareholding. The risk to market stability increases further in an already challenging macro economic environment. The total pledge works out to Rs1.1 lakh crore worth of market capitalisation as on 18 November 2011.[4]

Share Price Volatility

Pledging of shares, as observed in the analysis above, seems to have become a norm among promoters in India. It is believed to be one of the precursors of volatility in the market as lenders need to maintain a certain level of margin money.

We have analysed the shareholding pattern of BSE 200 companies in order to examine the link, if any, between promoters' pledged shares and capital markets instability. We have examined share price volatility with variations in number of pledged shares (submitted quarterly to BSE, as part of shareholding pattern filing) to ascertain if there is any co-relation (between the two)

Methodology and limitations: The study covers fourteen quarters beginning March 2009 till June 2012. For the purpose of the selection of the sample, companies with pledged shares in the preceding quarter or any time during the calendar year have been considered. For share prices, monthly closing price has been considered.

The analysis however does not:

- Reflect any movements within the quarter, during which the pledging and shareholding may have varied
- Similarly, any share price movements within the month are not reflected

Note: Disclosure of shareholding pattern information has been made mandatory with effect from January 28, 2009.

Observations of shareholding analysis: Consistent with the earlier findings, about 35% of the BSE 200 sample have pledged shares.

In the BSE 500 and BSE 200 both the promoters' shareholding and extent of pledging is quite high. This could expose the stock market to high price volatility, manipulation creating instability in the system.

Table 2.3: BSE 200 Companies with Pledged Shares

	12-Jun	12-Mar	11-Dec	11-Sep	11-Jun	11-Mar	10-Dec	10-Sep	10-Jun	10-Mar	09-Dec	09-Sep	09-Jun	09-Mar
Companies with pledged shares (no.)	66	66	65	66	68	72	65	70	73	73	71	71	71	74
Our sample size	66	66	74	74	74	74	76	76	76	75	80	79	78	78
Companies with pledged shares (%)	33	33	33	33	34	36	34	35	37	37	36	36	36	37

In almost half of these companies with pledged shares, the promoters hold more than 50% of the total shareholding implying that promoters with higher stake in their companies have a propensity to pledge shares.

Not only is the propensity to pledge high but the extent of it is also significant. In nearly 63% of the cases promoters have pledged up to 25% of their shareholding while in nearly 37% of the cases the promoters have pledged more than 25% of their holding. The stocks are already under a lot of pressure amidst a dynamic market scenario; companies exposed to pledging of shares might come under additional pressure in case a margin call gets triggered. This may have wide-ranging repercussions for instance volatility and instability in the market.

Pledging and Volatility: Does pledging really contribute to market volatility? To answer this question the sample was further reduced to those that had pledged shares. Monthly closing share price was tracked for this reduced sample with some interesting results.

Share Price Volatility for these companies has been calculated in the following manner:

$$\text{Share Price Volatility} = \frac{\text{Standard Deviation (Excel formula STDEVP) of share prices}}{\text{Closing Market Price as on the end of the calendar year}} \times 100$$

Observations of volatility analysis: The analysis shows that on an average 75% of the companies with pledged shares have also exhibited share price volatility greater than 10%.

Table 2.4: Volatility in BSE 200 Pledged Shares

Volatility (%)	2012*(%)	2011 (%)	2010 (%)	2009 (%)
Up to 10	52	28	33	1
10-20	39	28	43	35
20-40	9	19	12	58
40-60	-	9	3	4
60-80	-	7	-	-
80-100	-	3	-	-
>100	-	5	9	1
Total	100	100	100	100

*2012 volatility is for six months ending June 2012, where volatility has been low on account of low price movement at BSE[5].
Data Source: www.bseindia.com

As many as 75% of the companies with pledged shares have witnessed volatility greater than 10%. By itself the figure may not seem to carry much information, as share prices are oscillating all the time; the picture becomes clearer when we compare this to the volatility in the Sensex. Almost 80-90% of the companies studied exhibit greater volatility than Sensex.

Table 2.5: Comparison of Volatility in the BSE 200 Sample with the Sensex Volatility

	2012*(%)	2011 (%)	2010 (%)	2009 (%)
Volatility less than Sensex	12	18	7	18
Volatility more than Sensex	-	-	-	-
Up to 10 basis points	68	36	64	62
10 to 25 basis points	18	12	14	15
25 to 50 basis points	2	19	5	4
50 to 100 basis points	-	9	1	-
More than 100 basis points	-	5	8	1
Total	100	100	100	100

Data Source: www.bseindia.com

It's a similar story when we compare the volatility in the sample with volatility in BSE 200, a more comparable yardstick for evaluating the performance of the sample.

About 87% of the companies with pledged promoters' shares display more volatility than BSE Sensex or BSE 200 index. This may expose such shares to unnecessary swings and create greater unpredictability. **As a corollary we may state that companies where promoters pledge their shares exhibit high share price volatility.**

Volatility in the sample companies and movement in pledged shares: Volatility in share prices though a significant indicator may not, after all, be truly connected with activity in the pledged stock. Companies are required to file quarterly returns with details of shareholding, including the closing balances of pledged shares, separately. If some kind of concomitance is observed between the pledged shares and overall share price, it could be an indication of possible manipulation in stock prices. In order to explore this hypothesis, the sample was further refined to those which had experienced more than 10% share volatility to see if the movement in price had any relation with the movement in pledged shares.

Table 2.6: Association between Volatility and Pledged Shares

Qtr.	A (%)	B (%)	C (%)
Jun-12	24	63	50
Mar-12	50	67	59
Dec-11	50	51	63
Sep-11	32	71	59
Jun-11	7	60	33
Mar-11	12	78	86
Dec-10	11	75	50
Sep-10	13	100	90
Jun-10	12	78	71
Mar-10	7	100	100
Dec-09	10	75	67
Sep-09	16	69	78
Jun-09	79	65	78

Note:
A: Percentage of companies in the BSE 200 sample with volatility greater than 10%
B: Percentage of A with movement in pledged shares
C: Percentage of B with movement in pledged shares greater than 10%
Data Source: www.bseindia.com

The analysis shows that on an average in 70% of the companies had share price volatility greater than 10%, there was in fact movement in pledged shares; and in about 68% of these, the movement in pledged shares was greater than 10%.

It is fair and reasonable to conclude that companies with pledged shares exhibit greater volatility and increase or decrease in promoters' pledged shares might actually fuel market volatility.

The finding is further substantiated by the analysis of returns of companies with high levels of pledging—in case of companies with pledged shares above 25% of promoters' total stake, about 55% had lower capital returns than either Sensex or BSE 200.

It is fair and reasonable to conclude that companies with pledged shares exhibit greater volatility and increase or decrease in promoters' pledged shares might actually fuel market volatility.

Table 2.7: Returns of Companies with Pledged Shares >25 % of the Promoters' Stock

Qtr.	A (%)	B (%)	C (%)
Jun-12	47	65	58
Mar-12	45	23	37
Dec-11	41	77	73
Sep-11	32	71	71
Jun-11	38	46	46
Mar-11	38	79	79
Dec-10	29	77	73
Sep-10	26	55	55
Jun-10	33	48	60
Mar-10	31	48	48
Dec-09	30	42	42
Sep-09	33	50	50
Jun-09	41	22	31

Note:
A: Percentage of companies in the BSE 200 sample with pledged shares greater than 25%
B: Percentage of A with returns lower than Sensex
C: Percentage of A with movement returns lower than BSE200
Data Source: www.bseindia.com

Volatility leads to instability in capital markets and undermines investor confidence.

The above analysis has found beyond reasonable doubt a coincidence between instances of pledged shares and share price volatility. Volatility leads to instability in capital markets and undermines investor confidence. Lower confidence would tend to result in lower retail participation, thereby raising the cost of capital for the entrepreneurs/promoters. The uncertainty in long term price trend and expected rate of return over the short- and intermediate-terms are some of the direct consequences of the risk. Hence, high volatility coupled with high promoter stake is a cause of concern for regulators, companies and investors.

[2] See : http://www.livemint.com/2012/02/20003959/PE-firms-widen-indemnity-claus.html, last accessed 26/4/12
[3] Ghatak A. Promoters holding vs firm valuation: evidence from NIFTY stocks. The International Journal's Res. Journal of Social Science and Management 2011;1(7):187-207
[4] Crisil Research; Press Release; available on https://www.crisilresearch.com/ResearchProWeb/Published/OTH/OTH%20PRL/Pb75517.pdf; dated 24/11/11; last accessed 26/04/12
[5] http://www.bseindia.com/about/abindices/monthly_report/TheView_Jul_2012.pdf

03

STUDY OF MEGA ISSUES

Study of Mega Issues

Overview

India has a fairly well developed security issuance market, with an established network of intermediaries, operating in a competitive and regulated environment. The securities may be issued in the primary or the secondary market. The issue may be public in nature or private, in which case it is called a 'private placement', available to a select group of investors.

India has a fairly well developed security issuance market, with an established network of intermediaries, operating in a competitive and regulated environment.

Types of issues: The major types of issues are as follows:

- Initial Public Offer (IPO): It is the most common primary mechanism for raising capital. When an unlisted company makes either a fresh issue of securities or offers its existing securities for sale or both for the first time to the public, it is called an IPO.

  This paves way for listing and trading of the issuer's securities in the Stock Exchanges. Thus IPO is the first sale of stock by a company to the public.

- Follow on Public Offer (FPO): issue of shares by a public company that is already listed on an exchange. An FPO is essentially a stock issue of supplementary shares made by a company that is already publicly listed and has gone through the IPO process before this issue.

- Rights Issue: a company offers shares to existing shareholders in proportion to their current shareholding, on a particular date fixed by the issuer (i.e. record date). The rights are offered in a particular ratio to the number of securities held as on the record date.

- Private Placement: When an issuer makes an issue of securities to a select group of persons not exceeding 49, which is neither a rights issue nor a public issue, it is called a private placement. Private placement of shares or convertible securities by listed issuer can be of two types: Preferential Allotment and Qualified Institutions Placement.

- **ADR/GDR/ECB** : Apart from raising capital in domestic market, companies can also issue securities in international market through ADR/GDR/ECB route
- Bonus Issue: When an issuer makes an issue of securities to its existing shareholders as on a record date, without any consideration received for such issue, it is called a bonus issue. The shares are issued out of the Company's free reserve or share premium in a particular ratio to the number of securities held as on record date.

Price Manipulation Pricing of Issues:
Companies have been free to price their equity shares since 1992. However, this price has to be justified in the offer document or letter of offer. The issuer, in consultation with the merchant banker, decides the price based on assessment of the market demand. An issue is classified into Fixed Price issue and Book Built issue on the basis of pricing. When the issuer at the outset decides the issue price and mentions it in the Offer Document, it is commonly known as 'Fixed Price issue'. When the price of an issue is discovered on the basis of demand received from the prospective investors at various price levels, it is called 'Book Built issue'.
(http://www.sebi.gov.in/faq/pubissuefaq.pdf)

Issue Price Manipulation: In a study of capital markets in the US, it has been observed that an IPO is priced keeping the 'Sentiment Investor' and the possibility of 'Short Sale' in mind. The stock, first issued to institutional investors, is under-priced, giving them a window to maintain prices by restricting supply. The offer price is higher than the fundamental price but not aggressive.[6]

A study by Katharina Lewellen, based on NASDAQ data, has found that immediately following an IPO, underwriters often repurchase shares of poorly performing offerings in an apparent attempt to stabilize the price. Some of the key findings are: (1) Stabilization is substantial, inducing price rigidity at and below the offer price; (2) There is no evidence that stocks with larger information asymmetries are stabilized more strongly; (3) Larger underwriters stabilize more, perhaps to protect their reputations with investors; (4) Investment banks with retail brokerage operations stabilize much more than other banks, inconsistent with the view that stabilization benefits primarily institutional investors.[7]

Markus Buttgen examined initial public offerings (IPOs) that were conducted between 1998 and 2000. He found that they were manipulated by means of a practice called 'laddering' which artificially inflates share prices in the IPO aftermarket. Laddered IPOs are either underwritten by prestigious investment banks or venture capital (VC) backed. Laddering is especially prevalent in the offerings of young technology or internet companies and is accompanied by high levels of under pricing and price revision.[8] The process of price discovery in an IPO is complex and subject to several factors and chances of manipulation of prices seems to be a global phenomenon. Share prices may be manipulated at the time of fixing offer price during an IPO even in connivance with underwriters or merchant bankers. It can be also done before the shares are listed by creating artificial buying/ selling pressures by the brokers on their own discretion or direction by others. In secondary market prices may be manipulated through circular trading and synchronised deals. SEBI has advised Merchant Bankers to disclose the track record of the performance of the public issues managed by them in the public offer document, so that investor can take an informed decision. The track record is required to be disclosed for a period of three financial years from the date of listing of each public issue managed by the merchant banker.

The Price Discovery Process in the Indian Primary Market
We have examined the primary market issues for five financial years beginning April 1, 2006 to March 31, 2011 to analyse the price discovery process in the primary market in India[9].

Methodology: The sample has been restricted to mega issues only as defined in the annual reports of Securities and Exchange Board of India, which define mega issues as issues of size more than Rs 300 crores. The behaviour of other non-mega issues and their price discovery processes may vary from the findings. Preliminary evidence indicates that a period of six to eight months is required for a new issue to settle into a market-adjusted price, that is, what the market is actually willing to pay for the stock after the initial excitement of the issue dies down. Therefore this analysis looks at the price discovery process of the mega issues and tracks the capital returns on these issues over a period of eight months from the end of financial year in which it was issued.

Further, intra-day movement of the IPOs as well as the market swings/ downsides have been analysed to assess whether the issue price can hold its position on and just after the listing day. For the purpose of the study all mega issues in the category of IPO/ FPO & Rights issue have been considered. However, cumulative convertible preference shares/ debt instruments are excluded from the study because the pricing of these instruments is based on different considerations.

Definitions:

1. Share offer price is the price at which shares have been offered/ allotted to the subscriber.

2. Listing price is the closing price on the date of the listing of the scrip. In case of rights issue or FPO, the closing price on the date of opening of issue has been taken.

3. For the purpose of analysis closing price at the month end has been considered.

Table 3.1: Sample Size of Mega Issues

	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
Number of Mega Issues	20	28	8	26	29
Equity Sample tested (Rs crores)	26,106	72,293	12,487	12,487	51,164
Total amount of money raised from primary market (debt/ equity) (Rs crores)	33,508	87,029	16,220	57,555	67,608
Percentage of sample	78	83	77	89	75

For a detailed break-up of the amount raised through Mega Issues please refer Annexure 3.

Observations—the Study of Mega Issues: About 23% of the companies in the sample studied closed at a discount from the issue price peaking at 31% in 2011.

Table 3.2: Comparison of List Price with Issue Price for the Mega Issues

List Price/Issue Price	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
At discount	-15	-18	-25	-27	-31
Change in price 0 to 10%	30	18	25	54	28
Change in price 10% to 50%	35	39	50	15	34
Change in price 50% to 100%	20	14	-	4	7
Change in price >100%	0	11	-	-	-
Total	100	100	100	100	100

Data Source: www.bseindia.com, SEBI

Many also gained over the offer price on the listing day, but it is not certain if it held up on the following days. Further analysis of price movements during the subsequent eight months shows that while on an average 29% of the issues trade at discount by the end of the first month, as many as 48% trade at a discount from the third month onwards and this percentage becomes more than 50% by the end of the seventh month.

When it comes to gains: 28% of the issues gained up to 10% by the end of the first month, but only 5% were able to retain it by the end of the fifth month. (Refer table 3.3)

Table3.3: Gains over the Offer Price During the First Eight Months

a) First to Fourth Month

Month	First					Second					Third					Fourth				
Particulars	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
At discount	30	21	25	38	31	25	29	75	46	48	30	29	75	54	52	35	39	75	38	52
Change in price upto 10%	15	21	38	42	24	10	14	13	31	10	5	14	-	12	14	5	14	13	15	17
Change in price 10% to 50%	40	36	38	15	34	40	39	13	19	34	50	36	13	31	31	35	25	-	42	24
Change in price 50% to 100%	15	7	-	4	7	15	4	-	-	3	10	11	-	-	-	20	14	13	4	3
Change in price >100%	-	14	-	-	3	-	14	-	4	3	5	11	13	4	3	5	7	-	-	3
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

b) Fourth to Eighth Month

Month	Fifth					Sixth					Seventh					Eighth				
Particulars	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
At discount	35	43	75	42	59	30	50	75	31	66	30	61	61	31	72	20	61	61	27	66
Change in price upto 10%	-	7	-	15	3	10	11	-	12	-	10	7	7	12	3	10	7	7	12	10
Change in price 10% to 50%	35	29	13	35	34	25	14	-	54	28	20	7	7	42	17	25	18	18	38	17
Change in price 50% to 100%	25	11	13	4	-	25	11	-	-	3	30	14	14	12	3	35	7	7	19	3
Change in price >100%	5	11	-	4	3	20	14	25	4	3	10	11	11	4	3	10	7	7	4	3
Total	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100

Data Source: www.bseindia.com, SEBI

The price discovery process, following the issue of shares, takes a long time before the prices stabilise and the true market value of the scrip is established. This could be because most of the scrips are overpriced at the time of issue and later have to settle at prices below the issue price closer to their real value. Of the stocks analysed almost 43% experienced share price volatility of more than 25%. 80-90 % exhibited greater volatility than the Sensex—a reinforcement of the earlier finding. This warrants closer monitoring by the regulators. (Refer table 3.4)

The investors are not able to recover the investment even in the subsequent year. The prices of the scrips in the sample were tracked till October of the subsequent year post half yearly results, which is a significant milestone post listing. Even after a year 45% of the sample had negative returns. During 2007-08, while the Sensex gave a negative return of only 29%, the sample scrips had a negative return of above 90%. They continued to trade at a significant discount even in 2009-10, when Sensex appreciated by close to 76%.(table 3.5)

Table 3.4: Share Price Volatility of the Sample Compared with Volatility of Sensex

Particulars	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
More than Sensex	80	93	93	81	93
Less than Sensex	20	7	7	19	7
Total	100	100	100	100	100

Data Source: www.bseindia.com, SEBI

The issue price seems to bear little relation to market realities and in most cases volatility in mega issues is significantly above Sensex.

Table 3.5: Capital Returns on the Offer Price at the End of October of Subsequent Year

Return	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
Negative Returns	15	93	25	31	62
Return up to 10%	10	-	-	-	14
Return between 10% to 50%	20	4	25	46	21
Return between 50% to 100%	25	-	50	19	3
Return > 100%	30	4	-	4	-
Total	100	100	100	100	100

Data Source: www.bseindia.com, SEBI

The study wouldn't be overreaching itself in concluding that the issue price does seem to bear little relation to market realities. The volatility in the share prices of mega issues is significantly above Sensex. Investors have not realised significant capital gains through these mega issues from 2006-7 to 2010-11. Investors need greater protection and issue pricing needs to be more transparent.

Observations—Study of IPOs: The sample was further refined to include only IPOs to study issues' price behaviour on the date of listing on the stock exchange and the price swings impacting intra day movements.

Table 3.6: Total Number of IPOs

Particulars	2006-2007	2007-2008	2008-2009	2009-2010	2010-2011
Number of IPOs	16	19	1	16	17

We have examined the intra-day movement of share prices for these IPOs to ascertain the extent of fluctuations and how the issue price holds up on the crucial listing date. The analysis includes comparison among opening prices, closing prices, high and low prices on the listing day. Almost half the IPO scrips exhibited a variation on more than 20% on the listing day, indicative of high volatility on the day.

Table 3.7 Comparison of the High and Low Price on Listing Day

Variation between high and low price on listing day (as % of low price)	2006-2007 %	2007-2008 %	2008-2009 %	2009-2010 %	2010-2011 %
> 20%	56	58	100	38	35
15% to 20%	6	16	-	19	24
10% to 15%	19	21	-	19	24
Up to 10%	19	5	-	25	18
Total	**100**	**100**	**100**	**100**	**100**

Most of the companies are not able to retain the day's opening price during day's trading and close at a discount from the opening price. This seems to be an endemic problem with IPO market dynamics on the listing day whether the markets are in bull/ bear phase, indicating wide intra-day movement in prices. Nearly 74% of the issues closed at a price lower than the opening price. 14% of the issues gained less than 10%.

Table 3.8: Comparison of Opening and Closing Price (of IPO) on Listing Day

Variation between closing and opening Price on listing day(as % of opening price)	2006-2007 %	2007-2008 %	2008-2009 %	2009-2010 %	2010-2011 %
> 20%	6	5	-	13	-
15% to 20%	-	11	-	-	6
10% to 15%	-	11	-	6	-
5% to 10%	19	5	-	13	6
Up to 5%	-	5	-	6	18
Discount	75	63	100	63	71
Total	100	100	100	100	100

Data Source: www.bseindia.com, SEBI

To suup: there is significant volatility on the listing day and most (almost three fourth in the sample) closed at a discount to the opening price. Furthermore, in almost 41% of the cases across years, the opening price itself was at a discount to the offer price, suggestive of off-market operations. (Table 3.9)

Table 3.9: Comparison of the Opening Price on the Listing Day with Offer Price

Opening Price/ Offer Price on Listing day	2006-2007 %	2007-2008 %	2008-2009 %	2009-2010 %	2010-2011 %
> 20%	56	47	-	-	24
15% to 20%	13	11	-	13	12
10% to 15%	6	11	-	13	-
5% to 10%	-	-	-	13	18
0% to 5%	**13**	11	-	25	12
Discount	13	21	100	38	35
Total	**100**	**100**	**100**	**100**	**100**

Planned Control Measures—SEBI: SEBI has introduced circuit limits from January 2012, for IPOs. There will be an auction on the listing day open to all investors. The orders placed by them won't get executed until the end of the auction hour The best price, also called the "equilibrium" price, will be found by matching orders after closure of bidding. This is expected to curtail volatility. For IPOs of up to Rs 250 crore, the price band in the normal trading session will be 5% of the equilibrium price that is discovered in the call auction. For an issue size of more than Rs 250 crore, the price band will be 20%. However, if the equilibrium price is not discovered in the call auction, the price band in the normal trading session will be 5% and 20% of the issue price respectively. The trading will take place in trade-for-trade segment for the first 10 days that is by paying 100% margin for all buys in case of IPOs less than Rs 250 crores.[10]

How Successful is IPO Grading?

Grading is an attempt to simplify the task of evaluating complex IPO prospectus to arrive at an investment decision, for retail investors. Retail investors look for some assurance on the quality of an IPO before investing. A prospectus gives a lot of information to potential investors; however, it is a complex document and many potential investors may not possess the ability to grasp all information in the prospectus. Grading is more easily understood by the average investor as it gives a distilled perspective from experts regarding the quality of an IPO.

IPO grading is compulsory for all IPO issues with effect from May 1, 2007. It is a relative assessment of the fundamentals of the company comprising primarily the management quality, business prospects, corporate governance, financial performance and compliance track record. The study has mapped the IPO share performance, 180 days after the IPO, with the grading of the issue for the years 2009-2010 and 2010-2011.

In 2010-11 half of those graded 'five' and almost 90% of those with grading 'four' had negative returns. In 2009-10 the picture though somewhat better was still dismal, with almost half of those graded four delivering negative returns. There seems to be no correspondence between two: higher grading does not translate into higher returns; lower grading does not seem to be correlated with lower returns.

There seems to be no correspondence between the grading and capital market returns, higher grading does not translate into higher returns and lower grading is not correlated with lower returns.

Table 3.10: Comparison of Returns of IPOs with their Grading after 180 days

	2009-2010 %				2010-2011 %				
Return	Grade 2	Grade 3	Grade 4	Total	Grade 2	Grade 3	Grade 4	Grade 5	Total
Negative Return	-	13	19	31	6	24	53	6	88
Up to 25%	6	19	25	50	-	-	6	6	12
25% to 50%	-	-	-	-	-	-	-	-	-
50% to 100%	-	13	-	13	-	-	-	-	-
More than 100%	-	6	-	6	-	-	-	-	-
Total	6	50	44	100	6	24	59	12	100

Data Source: www.bseindia.com, SEBI

Therefore grading may not be a good indicator of future performance of scrip. Indian markets do not seem to have a robust method of pricing shares or price discovery. Volatility is high even on the listing day. The offer price does not seem to bear any relationship with the opening or closing price on the listing day, for that matter even after an year of listing.

SEBI Regulation: Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 require that the Merchant Bankers ensure all the requirements of 'Disclosure and Investor Protection Guidelines' are complied with at the time of submitting the draft offer documents to SEBI. The promoters of the company are required to contribute at least 20% of the equity issue at the time of listing. Merchant Bankers are required to disclose the price information of past issues handled by them and the due diligence certificate to the Board in the prescribed format; to disclose the track record of the performance of the public issues managed by them in the public offer document, so that investor can take an informed decision. Credit Rating Agencies (CRA) have been advised to follow the requirements, for transparency in the process, pertaining to rating process, methodology and its records. CRAs shall have an internal audit on a half yearly basis conducted by Chartered Accountants, Company Secretaries or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA. The internal audit shall cover all aspects of CRA operations and procedures, investor grievance redressal mechanism and compliance with the requirements stipulated as per SEBI.[11]

Indian markets do not seem to have a robust method of pricing shares or price discovery. The offer price does not seem to bear any relationship with the opening or closing price on the listing

[6] See Ljungqvist, Nov. 2003 , available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=282293, last accessed 26/4/12
[7] See Lewellen K, Dec. 2003, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=479925, last accessed 26/4/12
[8] See ButtgenM.,available at http://arno.unimaas.nl/show.cgi?fid=19356, last accessed 26/4/12
[9] SEBI Annual reports have served as a basis of selection of sample size of mega issues for the years 2006 to 2011. Annual report for March 31, 2012 is not available in public domain as on 22nd September 2012. Hence the sample size could not be extended to mega issues of financial year 2011-2012.
[10] For details please refer to Annexure 2
[11] For detailed circulars please refer Annexure 2

04

INFORMED TRADING

Informed Trading

Definition and Background

Insider trading is the buying, selling or dealing in securities of a listed company by a promoter, director, member of management , employee of the company, or by any other person such as internal auditor, advisor , consultant, analyst etc, who is privy to certain inside information relating to the company not available in the public domain to general public. It is legal as long as adequate disclosures as required by laws have been made and no undue profits have been made by the insiders that could not have been made by a person with similar knowledge. Insider trading has been one of the prime concerns of SEBI in the recent years. It can create lopsided advantage for those with access to privileged information. Insider trading arrests the smooth running / operation of the securities market and its healthy growth and development. It leads to loss of investors' confidence.

Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, does not directly define the term "insider trading". However it defines the terms insider, connected person and price sensitive information. Since any undue advantage to be derived from it is based on inequity of information, SEBI regulation focuses on removing this disparity. SEBI's moral code of conduct lays down certain trading restrictions on all directors, officers and designated employees. Designated employees are officers comprising the top three tiers of the company's management or the employees designated by the company to whom the restrictions shall be applicable. They are eligible to deal in securities only during a trading period known as "Trading windows" and this window shall be closed at certain crucial times such as :-

- Declaration of financial results
- Declaration of dividends
- Issue of securities by way of public/right/bonus etc.
- Major expansion plans or execution of new projects
- Amalgamation, mergers, takeovers and buy back
- Disposal of whole or substantial part of the undertaking
- Any changes in plans, policies or operation of the company

Moreover, for any investments beyond a threshold limit, a special pre clearance is required and the deal should be completed within seven days of the clearance. The Third Party entities in possession of such information due to their dealings with the organization also need to follow a "Chinese Wall" policy wherein only authorized officials can access a demarcated area of sensitive information. For the purpose of the study, a distinction has been made between trading by insiders permitted within the regulations of SEBI, which we call 'informed trading' and trading by persons acting on behalf of insiders, based on information obtained from them, which is the real 'insider trading'. While the former trade is subject to checks and balances, the latter is more dangerous and difficult to detect.

The Contrarion View: Insider Trading: Good or Bad?

Insider trading is not necessarily considered harmful to the health of organization by everyone. A point of view in support of it has also been developed. Ajay Shah in "Why forbid insider trading" has argued that insider traders speed up the flow of information and forecasts into prices via trading in securities markets, making them more efficient.[12] It contends that insider trading helps bring prices closer to their fair value. The state should simply focus on enhancing efficiency by imposing a reporting requirement. Trades by insiders are informative and promote market efficiency. In an paper titled, "The Insider: Parasite or Legitimate Profit-Maker?, Mark Miller" claims that the negative effects of insider trading has been exaggerated.

He elaborates that the arguments in favour of insider trading laws ignore the issue of use of information. Even if everyone has equal access to information, there is no guarantee that they will all use this information in the same way. Information must be analysed and different people have different opinions on what the best analysis of stock-related information is. The possession of inside information by itself is not as valuable as it appears to be at first. Investors who are too busy to read the financial section of the newspaper or to follow the latest information about the companies they invest in voluntarily allow information inequality to exist. Since so much inequality of information exists even when the government attempts to narrow the knowledge gap, equal access to information is a utopian goal.

By contrast, if an insider acts before the general public, the stock will still eventually reach the same price it would if there were no insiders trading in the stock. In other words, insider-trading laws are a way to ensure that gains from stock news are distributed equitably. A country with no insider trading laws, however, will only punish insider trading when there is a specific aggrieved party who is the victim of fraud or a breach of contract. The rest of the insider transactions that take place improve market efficiency by bringing prices closer to the price that would prevail under perfect information. He suggests that if India were to abolish its insider trading laws, it would improve the efficiency of its financial markets.[13]

The Study and Methodology

The study analyses the insider trading instances disclosed to BSE. Such declaration is updated periodically by BSE. The study examines the data as on December12, 2011.

The analysis pertains to BSE 200 index covering volatility, daily turnover, price discovery and the intra-day movement of such shares, in the following periods:

- Movements in preceding period (15 days before the date of transaction)
- Movements in post transaction period (15 days after the date of transaction)
- Movements in normal period (30 days before the beginning of preceding period)

Share price volatility for all the three periods mentioned above has been calculated using the formula:

$$\text{Share Price Volatility} = \frac{\text{Standard Deviation (Excel formula STDEVP) of share prices during the review period}}{\text{Closing Price as on the last day of the period}}$$

In case the first date or last date of the relevant period is a stock exchange holiday, the closest preceding trading day has been considered. The study tracked intra-day movements between high-low and closing-opening prices; closing prices on the first day of normal period, preceding period and post transaction period. The average turnover of shares during each of the three periods was also analysed.

Analysis and Observations

Greater share price volatility observed in the periods preceding and succeeding the day of the insider trade

- On comparison of share price volatility of the preceding period with the normal period, it has been observed that in 58% of the cases the volatility was higher in the preceding period.
- n comparison of share price volatility of the post transaction period with the normal period, it has been observed that in 67% of the cases the volatility was higher in the post transaction period.

Greater share turnover observed in the periods preceding and succeeding the day of the insider trade

- On comparison of the average turnover of traded shares in the preceding period with the normal period, it has been observed that in 42% of the cases the average turnover was higher in preceding period.

- On comparison of the average turnover of the number of traded shares in the post transaction period with the normal period, it has been observed that in 42% of the cases the average turnover was higher in post transaction period.

5 -10 % intraday swing observed in the price of the share on the day of the insider trade

- On the day of transaction, intraday swing between the high and low price as a percentage of low price was less than 5% in 73% of the cases and between 5% to 10% in 27% of the cases.

- On the day of transaction, intraday movement between closing and opening price as percentage of the opening price was to 5% in 55% of the cases and for balance 45% cases the closing price was lower than opening price.

Fall in price of the share observed on the day of the insider trade

- On comparing closing price on the transaction date with the closing price of first day of the preceding period: in 82% of the cases price on the transaction date was lower.

- On comparing closing price on the transaction date with the closing price of last day of the post transaction period: in 70% of the cases post transaction period price was higher.

- On comparing closing price on the transaction date with the closing price of first day of the normal period in 82% of the cases price on the transaction date was lower.

Conclusion

Informed trading transactions do seem to fuel share price volitality in a band of fifteen days both before and after the transaction day; when compared to the period before it, volatility is more prominent in post transaction period. This may indicate that investors other than promoters follow the cue of the promoters and mimic their actions.

The prices on the date of transaction are generally lower than the preceding and normal period. The market prices might have been manipulated to get the best deal for the informed investor.

Informed trading is allowed by the regulator provided adequate and timely disclosures are made to bring about informational efficiency. However, it may impair an unprejudiced price discovery process and stimulate volatility. The disclosure norms must be linked with underlying events leading to such informed transactions and made public. The reasons for the informed trade, such as increasing stake, combating takeover risks, offloading the stake or any other cause also needs to be disclosed.

Informed trading though allowed by the regulator provided adequate and timely disclosures are made can impair an unprejudiced price discovery process and stimulate volatility

[12] http://www.mayin.org/ajayshah/MEDIA/1998/insider.html
[13] http://ccsindia.org/ccsindia/policy/money/studies/wp0029.pdf)

05

SEBI MARKET REGULATION

SEBI Market Regulation

Securities and Exchange Board of India (SEBI) has been constituted under the SEBI Act. It acts as a developer and regulator of the capital market in India. How critical its function of regulation is , can be surmised from the fact that as on March 31, 2011 the total market capitalization of listed companies at BSE was Rs 68,39,084 crores. SEBI drafts regulations in its legislative capacity, it conducts investigation and authorises enforcement action in its executive function and passes rulings and orders in its judicial capacity. An appeals process is also in place to ensure SEBI's accountability through Securities Appellate Tribunal.

The quality of the enforcement environment creates the foundation of investor protection and fair play in securities market. The study tries to evaluate the same through:

- Study of the extent of adoption by listed companies of SEBI corporate governance norms.
- Study of effectiveness of SEBI's overall regulatory mechanism by analysing the first level of mechanism, that is, the Assessing Officer level as well as the appeals process, that is, the Securities Appellate Tribunal (SAT)
- Study of the mechanism of Consent Orders and analyse its prevalence, effectiveness as a deterrent and assess transparency of the system

Extent of Adoption of Corporate Governance Norms by Listed Companies

Analysis of company submissions of compliance report to SEBI for the quarter ended on 31st March 2012 by companies listed on National Stock Exchange shows that ninety one percent were fulfilling the clause 49 requirements.

Table 5.1: Compliance with Corporate Governance Norms

Compliance	Companies	%
Complied	1368*	92
Non Complied	129	8
Total	1497	100

Note: *Includes cases where certain clauses have been marked as NA to be complied at the time of annual report.

The above analysis does not cover the quality or extent to which the mechanisms have been employed and how the mechanisms benefit the individual companies.

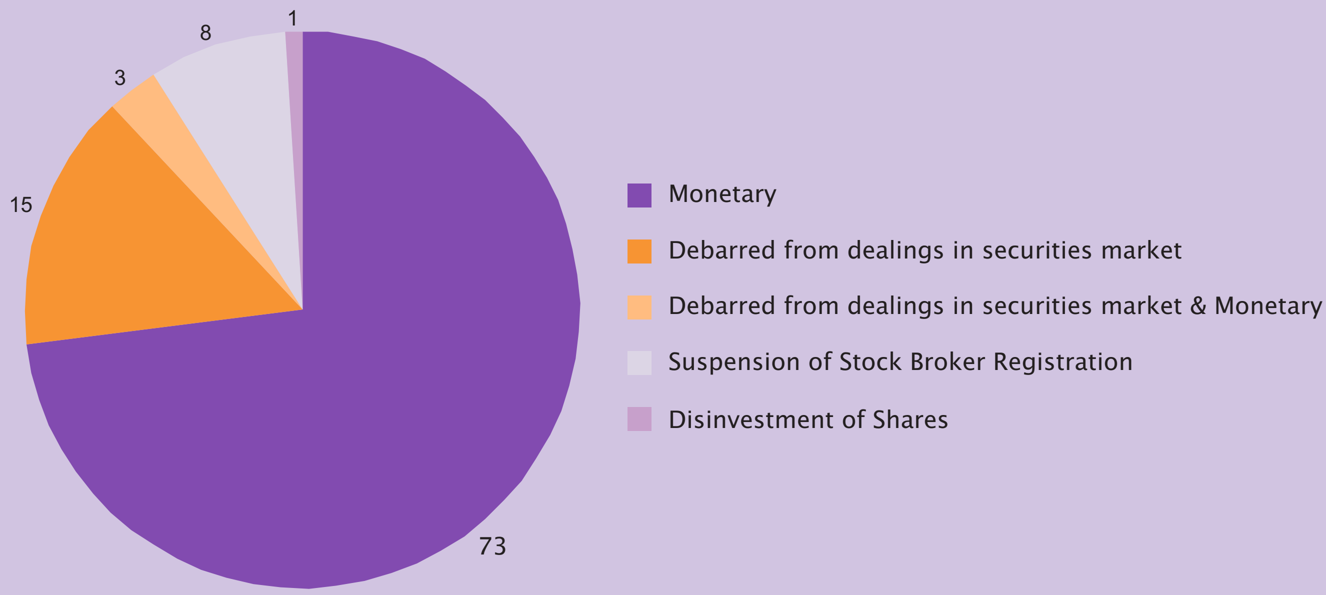
Effectiveness of Appeals Process i.e. the Securities Appellate Tribunal

Methodology: The study focus is on effectiveness of the first level of authority, that is, the Assessing Officer level and the appeals process, that is, the Securities Appellate Tribunal(SAT). The analysis covers 100 appeals and the corresponding 100 Adjudicating Officer (AO)/ SEBI orders passed to ascertain the effectiveness of the adjudicating and appellate process. The period of study for SAT orders is from March 1, 2010 to September 30, 2011 and the sample has been selected within the constraints of data availability.

The objective of the analysis is to study the nature of offences, time taken by SEBI in completion of adjudicating proceedings, nature of penalties levied; analysis of SAT orders whether it has taken independent decisions in favour or against SEBI and reduced the penalties for appellant ensuring law of justice, time taken to complete appeal proceedings at SAT and finally the time taken at SEBI's end for disposal of cases. The study, however, could not comment on final collection of the penalty amount by SEBI. (For assumptions and limitations of the study, please refer to Annexure).

Observations: Monetary penalty was charged in 73% of the cases while in 15% cases the violator was debarred from dealings in securities. Perhaps the regulator has shied from taking the route of the more stringent action of threat of debarment, which might prove to be a more effective deterrent.

Fig 5.1: Nature of Penalty Imposed by SEBI



Data Source: SEBI

The time taken to conclude investigations is as important as the kind of penalty imposed in discouraging wrong behaviour.

Fig 5.2: Ageing Analysis of AO and SAT Orders

Data Source: SEBI

Conclusion

I. **Time taken to initiate action:** In 25% cases the AO has been appointed within a year. However in 35% of the cases it took more than 4 years for SEBI to appoint an AO. That is, there is a delay of as long as 4 years to initiate punitive action from the time of violation. This may result in loss of evidence and reduce chances of bringing the violation to book.

ii. **Time taken to initiate proceedings:** In 65% cases the show cause notice was issued within 6 months, whereas in 32% cases it took more than 6 months to issue the same. In 4% cases the show cause notice was issued after 36 months. There is no prescribed standard time within which the AO is required to issue a show cause notice, which leaves room for discretion.

iii. **Time taken to complete the enquiry process:** In 37% of the cases the proceedings have been completed in one year. However in 40% cases it took more than 2 years to complete proceedings. Such long periods carry the risk of destruction of circumstantial evidence or the defaulter becoming untraceable and increasing investor losses.

iv. **Time taken to punish the offence:** In 25% cases the AO/SEBI order is passed within 3 years whereas in 56% cases it took more than 5 years to pass an order. The time taken is too long to provide any kind of effective deterrence to serve as an example.

v. **Time taken by SAT to complete appellate proceedings:** In 59% of the cases SAT proceedings have been completed within 6 months. This shows efficiency in disposal of cases by SAT which, however, is an appellant authority and not a primary court of enquiry.

vi. **Time lag between date of offence and final SAT order:** A comparison of the date of SAT order with date of offence to ascertain the time lag between the time of non-compliance and the final indictment after first leg of appeal process is complete reveals it takes more than 5 years in 64% of the cases from the time of offence to the time of disposal of appeal at SAT with 16% in more than 9 years bracket.

The appeals process seems to be slow and also often arbitrary and opaque. The framework is as per the best practices of justice and fair play; implementation seems to be a problem. The entire process of enquiry, adjudication, trial, decision and appeal needs streamlining, with clear and reasonable timeline to be strictly enforced, if SEBI is to perform its role as a gatekeeper.

Analysis of Consent Orders and their Effectiveness

Normal litigation in courts in India is known for its involved proceedings and huge backlog. Often alternatives have been established to expedite a particular class of cases. The Consent Order is one such initiative. According to the SEBI guidelines of April 2007, a consent order means "an order settling administrative or civil proceedings between the regulator and a person/party who may prima facie be found to have violated securities laws. It may settle all issues or reserve an issue or claim, but it must precisely state what issues or claims are being reserved. A consent order may or may not include a determination that a violation has occurred."

Consent order allows compounding of offence whereby an accused pays compounding charges in lieu of undergoing consequences of prosecution. Consent orders serve as an alternative to litigation, lengthy proceedings and consequent delays. Consent Orders can be passed in respect of all types of enforcement or remedial actions including administrative proceedings and civil actions. Any person who is notified that a proceeding will be initiated/instituted against him/her, or any party to a proceeding already initiated/instituted, may, at any time, propose in writing for settlement. Consent orders are aimed to reduce the regulatory cost, time and effort spent on pursuing enforcement actions.

Consent Order Analysis-Methodology: The Study examines the mechanism of Consent Orders and analyses its prevalence and effectiveness as a deterrent and vehicle for transparency in the system. It has two components. The first, analyses a period of two years from September 1, 2009 to September 30, 2011:

Fig 5.3: Quarterly Breakup of Consent Orders

Data Source: SEBI

Observations: The consent orders declined from 37 cases in month of September 2009 to 10 cases in September 2009. There were also multiple consent orders for the same client. In the case of some 12 applicants, two to four orders were passed. The actual number might be higher due to difficulty in separating individuals from group entities acting in concert, in some applications. Therefore it's quite probable that compounding of offences, which the consent order route enables, might be getting misapplied letting repeat offenders off the hook. Though, originally envisioned as an efficient alternative to lengthy litigation, over-use for this mechanism may help offenders get away by paying a paltry sum as penalty, discouraging honest law abiders in

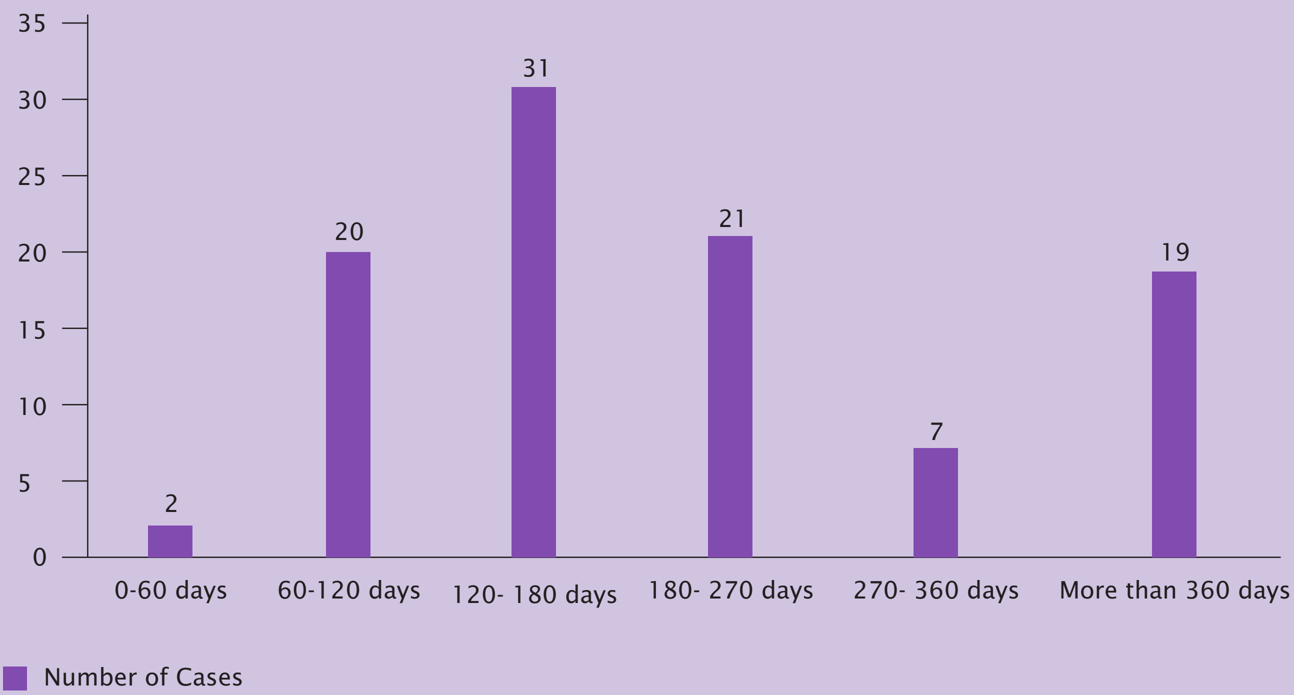
In the second component of the study: a sample of 100 consent orders from the same period was analysed further (*www.takeovercode.com, www.watchoutinvestors.com*). On comparing the date of application for consent with the date of order to determine the time taken in this process, it was found that Consent Orders positively expedite the resolution of old cases, fulfilling their overt purpose. 53% of the cases were resolved within 180 days; another 28% were wrapped up in 180-360 days.

normal

route. There are no clear guidelines regarding the type of cases that may be settled through the consent order route, leaving considerable scope for discretion.

Expeditious and proper handling of the cases goes hand in hand with corresponding and appropriate penalty. Section 15 of the SEBI Act stipulates the penalty to be levied for delay in filing returns or to address investor

Fig 5.4: Ageing of Consent Orders (Sample of 100 Orders)



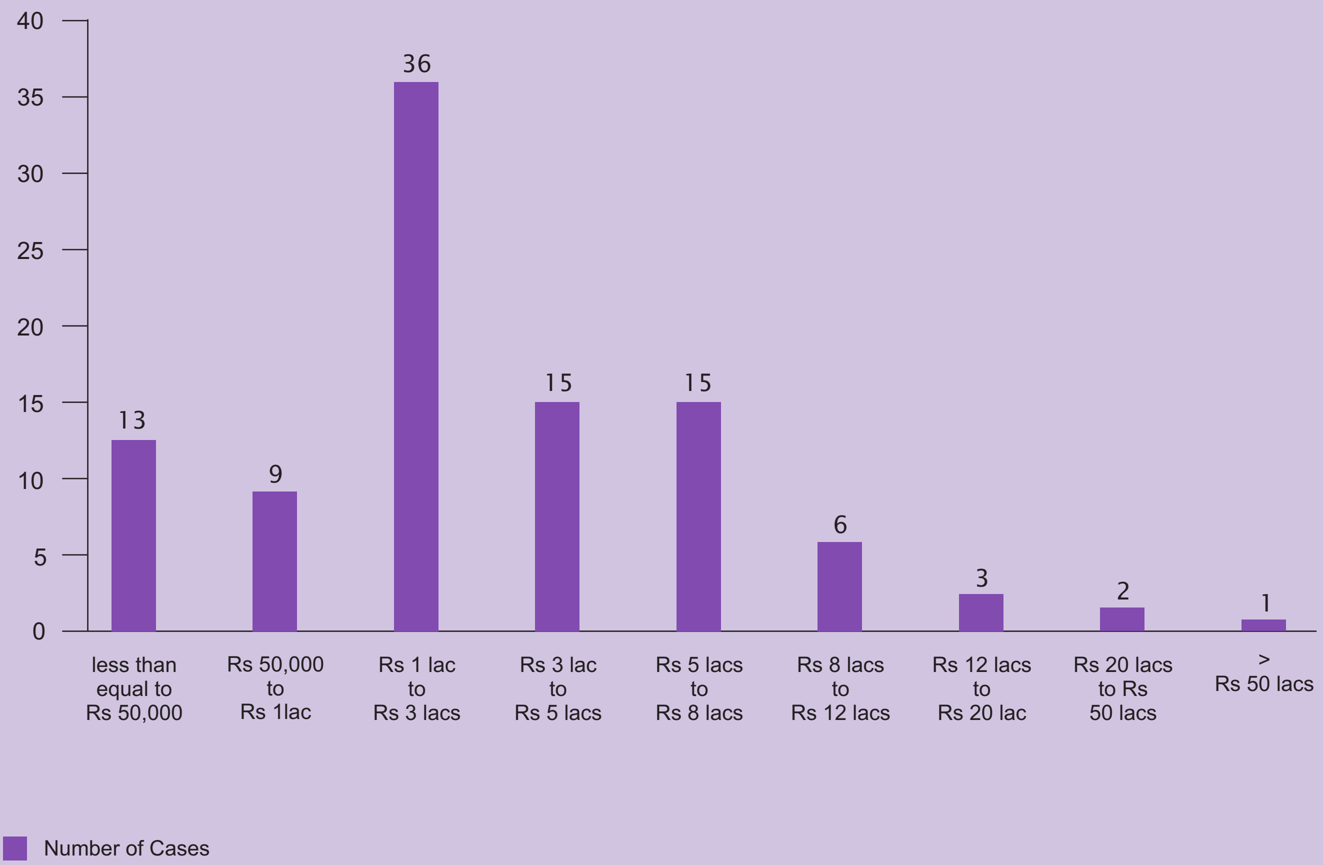
Data Source: SEBI

On analysing the age of these cases, it was discovered that 35 % of cases, which were more than seven years old have also been settled via this route, thus avoiding costs and delays in lengthy legal proceedings (perhaps the only way they could have concluded the case).But about 24% of the cases settled through consent orders were less than twelve months old where SEBI could have taken the

grievances to be Rs 1,00,000 per day subject to maximum of Rs 100,00,000. In case of mutual funds, stock brokers, asset management companies, additional limits have been also specified. In case of insider trading, non- disclosure of acquisition of shares and take overs, fraudulent and unfair trade practices penalty is 3 times the amount of profit made out of such practice or Rs 250,000,000 whichever is higher.

Thus, theoretically, in the sample of 100 cases, SEBI could have levied a minimum penalty of Rs 100 lacs and in some cases Rs 2,500 lacs. However, the actual results differ considerably:

Fig 5.6: Breakdown of Penalty Levied

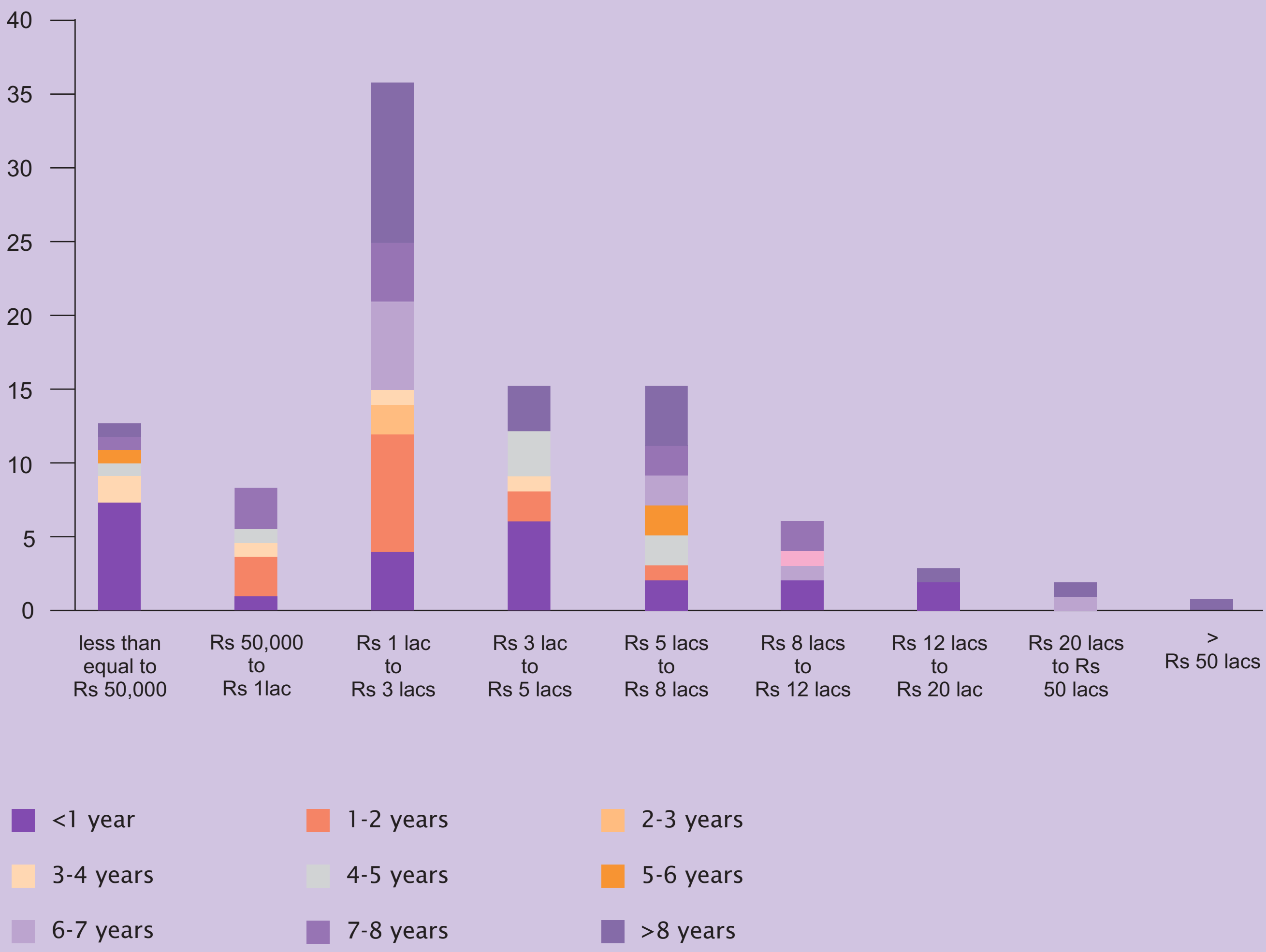


Data Source: SEBI

In 58% of the cases penalty levied is less than Rs 3 lacs, possibly indicating revenue loss to SEBI, perhaps not a stringent enough application of the provisions leading to a weaker monetary deterrent for lapses.

Moreover no correlation could be found between ageing of cases and the amount of penalty, suggesting some subjectivity in its application.

Fig 5.7: Comparison of Penalty with Age of Cases



Data Source: SEBI

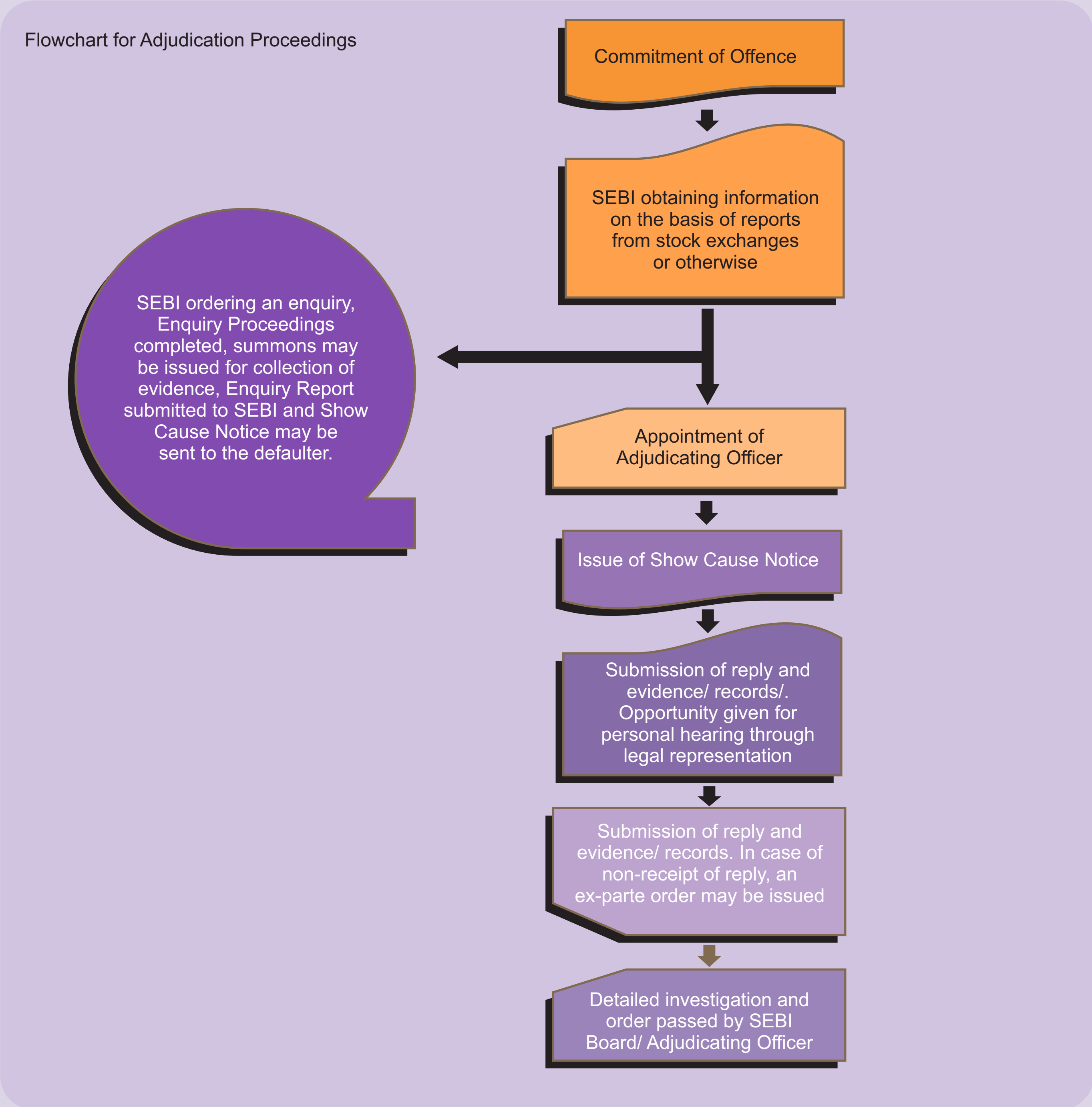
Although SEBI is a young institution it has been fairly successful in fulfilling its mandate as the capital market regulator, ensuring deepening of markets and increasing participation of investors. However the enforcement process tends to be somewhat arbitrary and rather opaque and leaves scope for discretion in the hands of officials.[14] The system of enforcement is also slow as these statistics show: as per Annual Report of SEBI for 2010-2011 (pp 110-112) there are 3,493 pending cases as on March 31, 2011. On analysis of these cases we find that as many as 32% of the pending cases have an ageing of 6 or more years, while 28% of the cases have been pending for 3 to 5 years. During the year 2010-11, a total of 1801 cases were disposed of by SEBI: out of these, 9% of the cases pertain to 2004-2005 (more than 6 years old), while 41% of the disposed cases are 3-5 years old. Only 18% of the cases pertain to 2010-2011.

The system of Consent Orders while efficient in terms of settling long pending cases also seems opaque in terms of: amount of penalty levied, timelines involved in settling of cases, criterion for accepting applications from repeat offenders etc. This calls for greater transparency and clearer guidelines so that the system builds confidence among all constituents.

[14] There have been amendments to the consent order process vide SEBI's circular dated May 25, 2012, for details please refer to Annexure II.

Annexures

Annexure 1A



Annexure 1B

Flowchart for Appeal Process
(At any stage an appeal can be filled with the Central Government of India)

Annexure 2

SEBI Regulations

Certain significant provisions pertaining to investor protection and interest in the securities markets are:

Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 apply to the primary market, i.e., public issues made by listed and unlisted companies, rights issues, and offers for sale by listed companies in certain cases. These guidelines include instructions for eligibility standards for companies issuing securities, pricing of securities to be issued by companies, pre issue obligations, contents of offer document, requirements relating to promoter contribution, and lock-in period for securities and more. The guidelines also describe the information that should be included in offer documents to the public, like a prospectus, abridged prospectus, and letter of offer. The Merchant Bankers are responsible for ensuring that all the requirements of Disclosure and Investor Protection Guidelines are complied with at the time of submitting the draft offers documents to SEBI. www. Sebi.gov.in

In case of non-compliance with these guidelines SEBI can direct the person to refund any money collected under an issue to the investors with or without interest, direct the persons concerned not to access the capital market for a particular period, direct the stock exchange concerned not to list or permit trading in the securities, direct the stock exchange concerned to forfeit the security deposit deposited by the issuer company, or any other direction as it may deem fit and proper.

b) SEBI has brought amendments to SEBI (Disclosure and Investor Protection) Guidelines, 2000 by mandating compulsory listing of IPO on at least one stock exchange with nationwide trading terminals, enlarging the scope of holding period of securities for calculating a period of one year in case of equity shares considered eligible for offer for sale and introduction of concept of anchor investor in public issues through book building

Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines 2000 apply to the primary market, i.e., public issues made by listed and unlisted companies, rights issues, and offers for sale by listed companies in certain cases.

route. Available at http://www.sebi.Gov.in/cms/sebi_data/ attachdocs/1289809510694.pdf last accessed on April 2, 2012.

c) The promoters of the company are required to contribute atleast 20% of the equity issue at the time of listing. There shall be no partly paid up share/ other securities at the time of filing of draft offer document with SEBI. Available at http://www.sebi.gov.in/cms/sebi_data/ attachdocs/1291175688427.pdf last accessed on April 2, 2012.

d) Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2011.

e) Securities and Exchange Board of India (Investor Protection and Education Fund) Regulations, 2009. The fund shall be utilised for the purpose of protection of investors and promotion of investor education. The fund can also be utilised for aiding investors' associations to undertake legal proceedings in the interest of investors in securities that are listed or proposed to be listed.

f) SEBI has advised Merchant Bankers to disclose the track record of the performance of the public issues managed by them in the public offer document so that investor can take an informed decision. The track record is required to be disclosed for a period of three financial years from the date of listing of each public issue managed by the merchant banker. Available at http://www.sebi.Gov.in/cms/sebi_data/attachdocs/1326184127412.pdf last accessed on April 2, 2012.

g) Merchant Bankers are required to disclose the price information of past issues handled by them and the due diligence certificate to the Board in the prescribed format detailing Issue Name, Issue Size, Issue Price, Listing Date, Opening & Closing price on the listing date along with the percentage change, Closing Price on 10th, 20th and 30th calendar day from the listing date along with the benchmark index on the respective dates. The Merchant Bankers are also required summary statement of disclosure for total number of IPOs, Amount raised, Number of IPOs trading at discount/ premium on listing day and on 30th calendar day from listing date. Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1317128055980.pdf last accessed on Aril 2, 2012.

h) Credit Rating Agencies (CRA) have been advised to follow the requirements pertaining to rating process and methodology and its records, transparency and disclosures, avoidance of conflict of interest, code of conduct, etc, as prescribed in the SEBI Regulations and circulars while carrying out rating of securities issued by way of public and rights issue and other securities / instruments and loans / facilities provided by banks which are not regulated by SEBI. Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1331706378217.pdf last accessed on April 2, 2012.

I) CRAs shall keep a record of the important factors underlying the credit rating and sensitivity of such credit rating to changes in these factors; summary of discussions with the issuer, its management, auditors and bankers; decisions of the rating committee; if a quantitative model is a substantial component of the credit rating process the rationale for any material difference between the credit rating implied by the model and the credit rating actually assigned for a period of five years after maturity of instruments. CRA shall publish information about the historical default rates of CRA rating categories and whether the default rates of these categories have changed over time, so that the public can understand the historical performance of each category. CRA shall formulate the policies and internal codes for dealing with the conflict of interests. CRA shall formulate and disclose its policies, methodology and procedures in detail regarding solicited and unsolicited credit ratings. Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1288154943197.pdf last accessed on April 2, 2012.

j) CRAs shall have an internal audit on a half yearly basis conducted by Chartered Accountants, Company Secretaries or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA. The internal audit shall cover all aspects of CRA operations and procedures, investor grievance redressal mechanism and compliance with the requirements stipulated as per SEBI. Available at http://www.sebi.gov.in/cms/sebi_data/attachdocs/1295346684641.pdf last accessed on April 2, 2012.

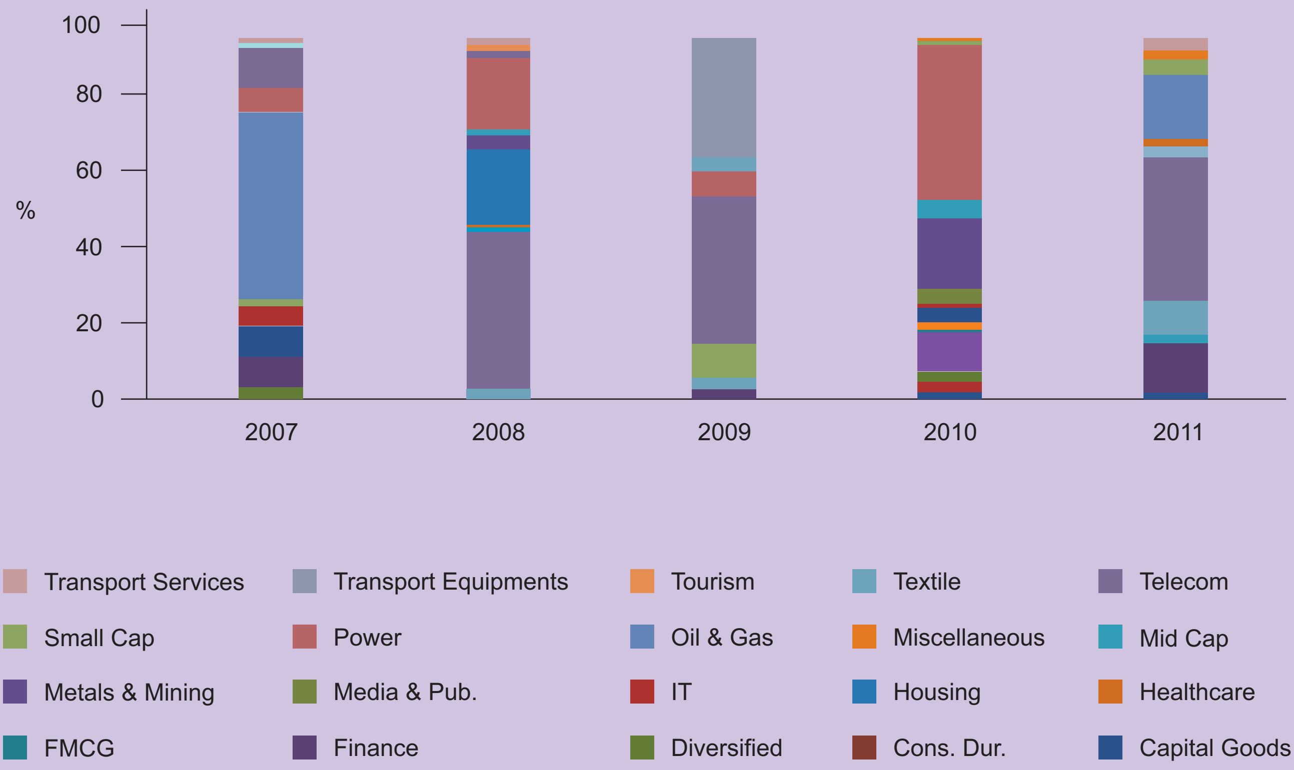
k) SEBI has amended "Issue of Capital and Disclosure Requirements Regulations" whereby in the case of an initial public offer, the minimum subscription to be received shall be subject to allotment of minimum number of specified securities. The promoter or promoter group shall not make institutional placement programme if the promoter or any person who is part of the promoter group has purchased or sold the eligible securities during the twelve weeks period prior to the date of the programme and they shall not purchase or sell the eligible securities during the twelve weeks period after the date of the programme.[15]

l) SEBI has modified the circular on consent order process, as a consequence of which insider trading, front running, failure to make an open offer, failure to redress investor grievances, fraudulent and unfair trade practices and response to the summons issued by SEBI have been excluded from the consent process. The consent application will not be considered, if any violation is committed within a period of two years from the date of any consent order. In case an applicant has already obtained more than two consent orders, no consent application shall be considered for a period of three years from the date of the last order. There cannot be consent application before the completion of investigation / inspection. In respect of proceedings pending before SEBI, no consent application shall be considered if filed after 60 days from the date of the service of the show cause notice.

The consent terms shall be determined on the basis of the guidelines. The significant ones being determination of consent amount on the basis of underlying default/ violation category & gravity, penalty imposed, track record of the applicant, profits made, nature of disclosure not made, its impact, etc. The consent terms may also include other directives viz. disgorgement of ill-gotten profits, etc. The HPAC/ Panel of WTMs considering the facts and circumstances of the case and the gravity of the charges, may enhance the settlement amount in serious cases as per the scheme of the SEBI Act, or reduce the settlement amount if the settlement amount is disproportionately higher considering the nature of violation, or refuse to consider the case under the consent process. In case of rejection of the consent application, no subsequent application with respect to the same default shall be considered by SEBI at any stage thereafter. SEBI shall dispose of the consent application expeditiously preferably within a period of six months from the date of registration of the consent application.[16]

Annexure 3

Fig 3.1: Breakup of Mega Issues by Industry



[15] http://www.sebi.gov.in/cms/sebi_data/attachdocs/1346045569469.pdf last accessed on September 24, 2012
[16] http://www.sebi.gov.in/cms/sebi_data/pdffiles/23777_t.pdf last accessed on September 24, 2012

Annexure 4

Assumptions of the study / Limitations of the Data

1. Samples of 100 appellants with maximum of 2 appellants in one SAT order have been considered.

2. Date of offence is the first date of violation. In cases of offence relating to noncompliance with summons issued by SEBI, date of offence has been taken as the date of 1st summons issued.

3. Date of appointment of adjudicating officer could not be found in case of ex-parte orders/ investigations ordered by SEBI/ otherwise (32 such cases). We could not ascertain the reasons why this date was not written in the orders. In 5 cases, date of appointment of adjudicating officer is after the date of show cause notice which are essentially show causes issued by enquiry officer, these have been taken as enquiry cases.

4. In one case, no show cause notice has been issued, hence the date of show cause cannot be analysed.

5. To ascertain whether the outcome of SAT order was in favour of SEBI/ Appellant, following assumptions have been taken:

- Appeals decided in favour of Appellant comprise of cases where the order has been completely set aside or the monetary penalty has been reduced to zero.

- Appeals decided in favour of SEBI consist of cases where there is no reduction in the penalty or the order has been withheld by Appellant.
- Cases withdrawn unconditionally or cases settled thru consent order have been also clubbed under the category of favourable to SEBI.

- Appeals where the order has been withheld but the quantum or conditions or amount of penalty has been reduced by Appellate have been taken as Relief to Appellant. In case the order has been sent back to SEBI for further investigation or a fresh order have been also considered as relief to Appellant.

6. In order to determine the nature of violations, clubbing has been done in the following manners:

a) Price Manipulation comprises of the cases where promoters or directors or broker or company has involved itself in synchronised/ circular/ cross deals to create artificial volume and rig securities prices. It also consists of cases whereby false or misleading corporate public announcements have been made or insider trading has been done.

b) Takeover violation comprises of the cases where the regulations relating to takeover code i.e. Disclosures of more than 2%/5% voting rights, shareholding pattern by the company have not been followed.

c) Investors grievances' relate to the companies delays in dematerialisation of shares, non-redress of investors grievances, huge selling in the shares with an objective to defraud investors, delay in refund of investors' funds, non-implementation of moral code of conduct to protect investors interest.

d) Violation of code of conduct of brokers encompass the cases where the brokers have not maintained proper books of accounts, segregation of client moneys and own funds, fund based activities, unauthorised terminals, KYC norms non-compliance etc.

e) Non responsiveness of summons issued by SEBI includes the cases of zero response or non-cooperation as to the quantum & timeliness of information submitted.

f) Failure to pay stock broker registration charges on a timely basis.

g) IPO manipulation includes the cases where fraudulent financing of IPOs have been done to oversubscribe the shares and make disproportionate profits on the date of listing or create benami shareholding. It also includes subscription to avoid under subscription of shares.

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Thought Arbitrage Research Institute (TARI) is a not for profit organization set up under Section 25 of the Indian Companies Act. TARI is one of the few privately-funded, independent and non-partisan Indian think-tanks on Corporate Governance, Sustain ability, Economics, Public Policy.
Today research in such areas is usually funded by the government, bilateral agencies or foreign universities; there is very little privately funded research that puts forth an unbiased and a non-partisan point of view.

TARI attempts to bridge the gap in the area of thought development. This research will ultimately contribute to reducing the cost of capital for India as more business decisions will be based on researched facts rather than opinions.

Tomorrow's arbitrage will not be on labour, cost or capital—but on knowledge, ideas and thought. Countries that are ahead in these areas will control the course of global economic power.
We intend to become an intellectual bridge between business and society so as to ensure that; Business can be more responsive to needs of society and can add more value, Society can create an environment in which business can thrive, Business & Society can transcend their pre-dispositions/concerns and come together to address critical human issues.

About Grant Thornton India LLP

Grant Thornton India LLP is a member firm within Grant Thornton International Ltd, one of the six largest global accountancy organizations, and the global leader in serving the needs of dynamic privately held businesses. From its origins in 1935, the firm has today grown to be one of the largest accounting and advisory firms in India with over 1,100 professional staff based out of 10 locations in the country.

The firm's mission is to be the advisers of choice to dynamic Indian businesses who have global ambitions- raise global capital, expand into global markets or adopt global standards. The firm specialises in providing compliance and advisory services to growth oriented, entrepreneurial companies and adopts best in class international tools, methodologies and risk management standards for all its services

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On public equity markets, our partners coordinate Indian and cross-border capital-raising exercises such as listing on the Bombay Stock Exchange (BSE), National Stock Exchange (NSE) or in other markets. Such transactions are complicated and need to be carefully considered. As the most active nominated adviser on the London Alternative Investment Market (AiM) and a member of the NASDAQ listing committee, we are well-placed to work through the rationale with a client to ensure that a cross-border listing is in the best interest of organisation.

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- Fraud risk assessments
- Fraud awareness workshops
- Asset tracing

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