Delisting of Shares

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Introduction

The mechanism of transfer of resources from the savers' community to entrepreneurs gets strengthened when an exit route is provided to the savers (investors) in case they would like to move away to another form of investment. This exit route may be a regulatory requirement or a voluntary one depending on the nature of investment. All over the world the exit route is provided to investors with the help of issuers, intermediaries, stock exchanges, regulators, Government, etc. Listing of the securities is the most preferred route as this provides all concerned an exit route that is relatively cheaper. In India, there is regulatory fiat requiring companies raising money in public issues to mandatorily list the securities in a stock exchange. Companies, in order to provide better liquidity to the investing public at large prefer to list in multiple exchanges. Listing means admission of securities of an issuer to trading privileges on a stock exchange through a formal agreement. The prime objective of admission to dealings on a stock exchange is to provide liquidity and marketability to securities, as also to provide a mechanism for effective management of trading. The provisions of listing has been enumerated clearly in three legal enactments viz., Section 21 of the SCRA, Section 19 2 (b) of SC(R)R and Section 73 of the Companies Act. However, there has been no mention of delisting in any of the legal enactments, possibly the regulators, did not want the companies to delist keeping in mind the benefit of listing to investors. Section 21 of the Securities Contracts Regulation Act, states "Where securities are listed on the application of any person in any recognised stock exchange, such person shall comply with the conditions of the listing agreement with that stock exchange". Hence the listing requirement flows from the regulations. It can also be construed that the investor takes the decision of investing his money in a public company on the basis of issue document which specifically provides for listing and this requirement is purported to have a continuing and possibly an irreversible concept. The regulations laid down has always emphasised on the strengthening of the listing agreement but none specified the rules and regulations for delisting norms. Under section 19 (2) (b) of the Securities Contracts (Regulation) Rules, 1957 it is said that " At least 10% of each class or kind of securities issued by the company should be offered to the public for subscription through advertisement in newspapers for a period

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not less than two days and that applications received in pursuance of such offer shall be allotted subject to certain conditions. If a company does not fulfill the stipulated conditions, it shall offer at least 25% of each class or kind of securities to the public for subscription through advertisements in newspapers for a period not less than two days and that applications received in pursuance of such offer shall be allotted.

Listing means a formal admission of a security into a public trading system, usually a stock exchange, often substantiated by a listing agreement between the issuer of the security and the stock exchange. Listing thus provides liquidity to the investors without compromising the need of the issuer of security for capital and ensures effective monitoring of conduct of issuer and of trading of securities in the interest of investors. So more the shares get listed on stock exchanges, more will be the possibility of liquidity in the market. And need not to mention, on investment avenues, liquidity is one of the most important criteria from investors' point of view. That is why when companies get listed on more than one exchange, it invariably widens the investors base. And in event of any de-listing (whether permanent or temporary), it affects the depth and liquidity of the market, resulting in loss of investment avenues for the public and also reducing the wealth of the securities market. The investors subscribe to an issue on behest of the promises made by the promoter of the company in the prospectus. Since the investors' decision is irreversible, the promises in the prospectus should also be irreversible, which also means that any security once listed should never be allowed to be delisted.

During last couple of years there has been public debate on the issue of strengthening of listing norms and rules regarding delisting of companies, and hence few committees were set up to specifically look into various aspects of the matter. One aspect which gained momentum is the concept of "de-listing" of securities from the stock exchanges. The delisting can be voluntary or involuntary. The ***involuntary delisting*** involves delisting by exchanges on account of any disciplinary action initiated by either the Exchanges or by SEBI on non-fulfillment of the listing criteria set by the exchanges. And the voluntary delisting is due to the decision taken by the company to de-list from a particular exchange or all exchanges as the case may be. Voluntary de-listing of shares from Indian stock exchanges has become a major issue for the market regulator to handle. ***Voluntary delisting*** is a condition when the issuer company no longer wants to be on the trading platform of the exchange and exits out of the Exchange. Involuntary delisting by stock exchanges is an extreme measure of disciplinary action may be due to non-payment of listing fees, non-compliance of the required provisions of Exchange and SEBI guidelines by a company, which if indiscriminately used, would adversely affect the interests of the investors. However, voluntary delisting sometimes is beneficial for the existing shareholders in case of companies which can no longer pay the listing fees or comply with the norms stated (compliance also costs money), due to constant loss or other constraints leading to erosion of the shareholders wealth of that particular company.

Thus, the first and foremost issue to be dealt with is *"whose interest does delisting of shares serve and why is there a need for delisting"*. It makes economic sense for companies to opt for voluntary delisting in case the listing is a drag on the performance of the company. Hence, the debate of delisting is today more centered around the companies who have been making profits and have potential for growth in future but the present management would like to consolidate their holdings and control in the company by way of acquiring the shares either through buy-back offer or through open offer. It is felt in some quarters that such delisting is proper in regulatory sense but may not be ethical in the sense that it deprives the market of good stocks, makes the investment illiquid for the investors and the present management uses the shareholder's money to buy back the stocks from the market. However, there is another side to the argument that says that the stakeholders have been provided with the best possible price offer as regulations provide for.

Listing Provisions

Listing of securities on Indian Stock Exchanges is essentially governed by the provisions in the Companies Act, 1956, the Securities contracts (Regulation) Act, the Securities Contracts (Regulation) Rules, 1957, rules and bye-laws of the concerned stock exchange, the listing agreement entered into by the issuer and the stock exchange and the guidelines issued from time to time by the Central Government and SEBI. The Companies Act of 1956 requires a company intending to issue securities to public to seek permission for dealing with its securities on one or more recognised stock exchanges. The prospectus would state the names of the stock exchanges where application for listing has been made, and any allotment of securities would be void if permission for listing is not granted by all the stock exchanges before expiry of 10 weeks from the closure of the issue. If application for listing is not made or if permission is not granted, the company shall repay all the money received from the applicants within 8 days. Section 69 of the Companies Act, 1956, also states that where the minimum subscription amount has not been raised by the company within the expiry time, then the moneys received from the applicants for shares are required to be repaid without interest. The SC(R)R also prescribes requirements regarding listing of securities on recognised stock exchange and confers the right on a recognised stock exchange to suspend or withdraw admission to dealings in the securities either for breach of or non-compliance with any of the conditions of admission to dealings or for any other reason. The listing agreement contains a provision requiring the issuer to irrevocably agree that unless the Exchange agrees otherwise, the issuer will not, without the previous permission in writing of the SEBI, withdraw its adherence to the agreement for listing. It also requires an issuer to agree that any of its securities listed on the Exchange shall remain on the list entirely at the pleasure of the Exchange which has the right to suspend or remove from the list the said securities at any time and for any reason which it considers proper in its discretion.

In order to strengthen listing provisions and to make it cheaper for all concerned, the concept of Central Listing Authority has been mooted. There has been arguments in support of the concept as well as opposition to the same. It has been argued that regional exchanges who survive on the listing fees would be wiped out from the system. The moot point here is that these regional exchanges do have some utility for the investing public as well as to the companies. Hence, if we go for a centralised listing concept, their interest needs to be kept in mind.

De-listing Provisions

There have been certain guidelines issued from time to time for those companies who wish to de-list from the stock exchange. In a circular issued by the Central Government, the stock exchanges were empowered to permit delisting of securities if the audited accounts of the company, has incurred losses during the preceding three consecutive years and the net worth has been reduced to less than its paid-up capital, the securities of the company have remained infrequently traded during the preceding three years and the securities of the company remain listed at least on the concerned regional stock exchange. In December 1997, a committee set up by SEBI under the chairmanship of Dr. K. R. Chandratre to study and to facilitate delisting provisions submitted its report. The major recommendations of this committee were:

(i) The stock exchanges would permit delisting of the securities in the stock exchange other than regional stock exchange if the company remained infrequently traded and had incurred losses during the preceding three consecutive years and also if the net worth had been reduced to less than its paid-up capital. However, in practice stock exchanges have been de-listing securities mostly because of non-payment of the listing fees as well as non-availability of the reports etc. as per listing agreement.

(ii) Companies who went for voluntary de-listing in all stock exchanges other than regional stock exchange would make arrangements to give "buy-back" offer to all shareholders in that particular region. In addition to these, it was also recommended that the companies would take three years advance listing fees to be kept in the escrow account with the stock exchange.

These recommendations tightened the de-listing norms but were not full-proof and did not address the issue of the protection of the investors in case of voluntary delisting by the companies. The committee recommended exchanges not to resort to delisting of securities on the ground of non-payment of listing fees unless the efforts made for recovery of the fees by persuasion or force through all other remedies available had failed. Besides, specific provisions were also stated on compulsory delisting and precise procedure were laid down to be followed. Mechanism for the compulsory delisting of securities were so stated that it provided for adequate and effective intimation to the holders of the securities which were proposed to be delisted. Such mechanism were also provided as a remedy to make investment in the securities liquid after they were delisted. For the said purpose, dealings in permitted securities were provided to give liquidity to the investors even after being delisted. However, many companies do not comply, at times, deliberately, with the conditions of listing. This normally invites a mild reaction of suspension of trading (temporary delisting). The concept of permitted securities was thought of for providing liquidity to the investors without much cost to the issuer company. The company remains available for trading to provide an exit route to the investor while the company does not have any cost for compliance for exchanges other than the regional exchange.

Over a period of time, it was seen that the delisting norms specified by the Chandratre Committee did not attend to all the issues of delisting and that the number of companies opting for de-listing grown. The exchanges should not de-list the securities on frivolous grounds, has been the focus point of the market regulator. A Committee was further set up by SEBI, which submitted its report recently. The recommendations by the recently set up committee does not restrict de-listing but have made the rules and regulations of de-listing more stringent and strict. Some of them are:

- The exit price for delisting would be accordance with book-building process.
- The offer price would have a floor price (a minimum base price) which shall be the average of 26 weeks traded price and without maximum price.
- Market forces shall determine the price above the base price. Stock exchanges shall provide the infrastructure to ensure transparency, whereby investors would see the prices on screens.

- To reduce the risk of manipulation, the scrip shall be under the watch by the exchanges

Considering all the issues involved and the regulatory provisions, it does not seem quite desirable to put an absolute ban on delisting but it may be discouraged for those companies who are in good health. For those companies who take this route, should provide a fair value to the minority shareholders. The valuation norms need to be re-looked as the investors should be sufficiently compensated. An economic cycle of recession and the resultant depressed capital market condition lasts on an average for a couple of years. Hence valuation methodology should keep this in mind before deciding on prices to be paid to the investors exiting out of the company. Like one of the recommendations of the recently set up committee suggests that the valuation should be done on taking the average of the 26 weeks traded price, it may not always reflect the true value of that particular company. However, 26 weeks time period may be of limited help to investors at the time of a bearish phase of the market and hence the time period need to be extended to take care of economic cycles that normally lasts for 12 to 18 months. And the pricing should be in terms of an weighted average price for the period as choosing a single price may not be always equitable and realistic in Indian scenario. Hence, review may be done to take the historical weighted average price of the security and then work out the value at which the investor will be adequately compensated. As delisting means a permanent exit, the true value of the company needs to be shared with its departing shareholders. If delisting is in the interest of investors, it must be permitted. If it is not in the interest of investors, they must be adequately protected.

The recent decision of SEBI on delisting through reverse book building process is a step in the right direction as it provides significant improvement so as compensation to investors exiting from the company is concerned. This mechanism would leave the option of pricing to the investors and would be totally transparent to the market. The market forces of demand and supply would help in determining the price level for the exiting shareholders. The present infrastructure of the stock exchanges can be utilised for the said reverse book building process and the investors would be able to view the ongoing prices through screens.

There may be case for framing guidelines to offer the best price to the exiting shareholders which would the best of the empirical weighted average price or the price determined out of the reverse book building process.

Major Issues

The incidence of delisting has been on an increasing trend in the recent past and has hence attracted lot of attention. Regulatory provisions as well as the guidelines issued from time to time has more relied on the case of delisting of companies to save resources as continuing listing has been considered to be not beneficial to the shareholders. The intent of law is not to encourage delisting by good and profitable companies that have potential for future benefits to the shareholders. This would not only be inconvenient for the investors but also would be inimical to the growth of capital market in the country. Here the hue and cry made is not in view of those companies who are loss making and have their net worth eroded away, but in view of the number of multi national companies and other growth oriented companies delisting themselves from the stock exchanges. According to prime database, there were 6 such offers in 1999 which jumped to 8 in 2000 and has now grown to an alarming number of 16 in 2001. Another 90 companies are believed to be in the pipeline.

The growing interest of companies seeking voluntary delisting in recent times has been mainly due to take advantage of the depressed capital market condition that has triggered off low prices of stocks. The continuing depressed state of the capital market has been a great help to these companies. Owing to the suppressed conditions in the secondary market, buying out the domestic shareholding comes quite cheap for MNCs. Delisting by multi national companies makes the Indian markets narrower, and worse is that, such de-listings are unfair to the shareholders who are practically forced to sell their holdings compulsorily, else they will be left with dead stocks or illiquid stocks. So, the question now is, whether de-listing should be allowed or not?

Pros and Cons

It is argued in some circles that delisting should not be permitted at all. The argument is that it is the intention of legislature, as listing of securities is governed by statutory provisions, rules, regulations, guidelines etc. while the law is conspicuously silent on the delisting. Only law that governs delisting is a circular of SEBI. It is probably considered that listing is so sacrosanct that once a security is listed, it should not be delisted. An investor subscribes to an issue on the basis of the contents in the prospectus which may state that the security would be listed on stock exchanges. Once he subscribes to the issue, he takes an irreversible decision, as the promises in the prospectus are irreversible. Hence if one considers investors interest to be the predominant and sole factor, there should not any delisting of securities. Once listed, a security should remain listed forever as long as the issuer exists. The terms and conditions of listing have to be enforced by recourse to other means rather than delisting.

Another view which supports delisting argues that listing agreement is essentially a contract between a company and the Exchange. Like any contractual relations, it must have also a way to terminate the relationship in certain circumstances. If there is a way to get in, there must be also a way to get out. Should the exchange and the company consider terminating their relationship, after taking care of interest of the affected investors, they should be permitted to do so. If a company has been incurring losses and its net worth has been reduced to less than its paid up capital, it carries on business at a risk to the creditors. In such cases there may not be any trading of shares. In this situation, if the company has to pay the listing fees, it harms the investor further, while no public interest or investor interest is served by continued listing. It may be desirable to allow a company to de-list its securities in such cases.

Conclusions

Thus the conclusion drawn from the above arguments is that though the answer to the question raised, *whose interest does delisting serve?* may not satisfy all and one but, the stress lies only on one point i.e., if delisting is in the interest of investors, it must be permitted and if it is not in the interest of investors, they must be adequately protected. For this we need to re-look at the valuation norms (time and again SEBI has been addressing to this problem and trying to find feasible solutions to the problem) that would also take care of the continuing depressed market conditions. Some amount of research needs to be done to figure out the business cycle changes in Indian conditions and that time parameter needs to be incorporated for compensation to investors who are forced to exit out of a company.

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