

## Share Fungibility - A Boon or Bane ?

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The Depositories Act, 1996 introduced the concept of dematerialization of securities in India. It was thought for once that all the perils related to shares would get removed completely. Dematerialization was considered panacea for physical perils. The most important and significant aspect of the concept of dematerialization was removal of the concept of identification of shares through distinctive numbers. It is called 'fungibility of shares'.

The idea of fungibility removed the controls maintained with distinctive numbers by the companies. Shareholders could sell or buy high value shares/securities in small quantum with a minimum of one share. With the introduction of compulsory dematerialization by SEBI, most of the companies have provided this facility to the shareholders. This is considered a great boon for the small, medium and retail investors. More and more people have started evincing interest in investment through equities resulting in huge increase in the number of retail investors. In fact now, the retail cult has spread to remote corners of our towns and villages where the word 'shares and securities' was unheard earlier.

Added to the facility of dematerialization, few more things like, stock split, internet trading has also contributed a lot to the increase in the number of retailers who invest in equities. With the reduction in the par value of the shares, most of the companies whose shares were out of reach to the common shareholder have become reachable.

Some of the tribulations identified are:

1. Bulging number of shareholders.
2. Enormous increase in the cost of servicing shareholders.
3. Enormous increase in the consumption of paper resulting in wastage of National productivity.
4. Unwarranted pressure on the management
5. Absolutely NIL contribution by the small shareholders.

While dematerialization has certainly acted as a boon for the investors, it is a bane for the companies and has created havoc in maintaining the members register, and in conducting members meeting. Though theoretically the depositories stand as the shareholders in the Register of members of the Company, the so-called beneficial holders who are the real shareholders has been on the increase. Statistics shows that the number of

shareholders of a company has increased multifold after dematerialisation and the reduction in par value. For example, a leading software company in India which had less than 7000 shareholders in 1997, has about three lakh shareholders today. Similarly, in the case of another leading company, which had less than 3000 shareholders in 1997 has more than 2 lakh shareholders holding dematerialized shares.

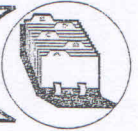
An analysis of the shareholding pattern of some of the companies shows that

more than 65% of the shareholders hold less than 5 shares and about 10% of shareholders hold shares between 6-50 and another 5% of shareholders hold shares between 50 - 100. Thus the concept of dematerialisation and reduction in par value has drastically increased the number of shareholders.

Increase in number of shareholders results in increased cost of service. The following are the areas, where by the cost of investor servicing has gone up for the companies :

- (a) Printing of Annual Reports : With the highest level of transparency expected by the companies the companies are required to disclose lot of information like notes on Corporate Governance, Management Discussion and Analysis, Risk Management, Industry Review, etc., in the Annual Reports. This has resulted in steep increase in the cost of printing a quality Annual Report for the Companies. In view of the fact that the number of shareholders have also increased drastically, the cost of printing of Annual Reports has increased by several folds in case of every company.
- (b) Cost of Mailing : Today Postage is prohibitive. Average postage per report would be around Rs. 5/-. A company with about 3 lakh shareholders would be spending a minimum of Rs. 15 lakhs on Postage itself! Cost of envelop and handling charges are added pain to the company. Another Rs. 15 lakh is spent on mailing dividend warrants, if any.
- (c) Conduct of the Meeting of Members : Consequent to increase in the number of shareholders, the number of attendees at the Members' Meetings such as Annual General Meeting has also increased multifold forcing the companies to make elaborate arrangements for conducting such meetings. This has a bearing on the cost of conducting the

*While "dematerialization" has certainly brought about lot of improvement in the investment habits in our country, it has also the flip side of it. It is high time that we take note of it seriously and do better to improve the system.*



meetings. Apart from the cost, the behavior and conduct of such small shareholders is wanting. Most of the time at Members' Meeting is wasted on unrelated and unproductive questions.

### SUGGESTIONS

It is strongly felt that SEBI should seriously review the following :

1. Members who are eligible to get a copy of the Annual Report of the Company. The Annual Report should be sent only to those shareholders holding a minimum number of shares. This would save a lot of time and cost for the companies in printing and mailing of the annual reports. The small shareholders may be sent an abridged form of accounts for information.
2. Members who are eligible to get an abridged copy of the Annual Report and their rights to get clarifications, if any, from the Company.
3. Members who are eligible to attend the Annual General Meeting of the Companies. To have a qualitative discussion on the performance of the company, it is essential that only

such serious investors are invited to attend the meeting. For example, shareholders holding a minimum investment of Rs.1.00 lakh should only be allowed to attend the Members' Meeting.

4. Members who are eligible to vote at the Meeting. Voting Powers of the large shareholders may be redefined to suit the changed circumstances and to take care of the interest of small and medium shareholders.
5. Going a step further, a National Level Debate among professionals may be taken up to consider the necessity of conducting of Annual General Meeting of the shareholders. In order to give wider opportunity to the shareholders across the country, especially in the context of introduction of postal ballots, use of internet based voting, etc., the companies may be asked to resort to use Postal Ballot or Electronic Voting System-rather than conducting the Annual General Meetings as a ritual. Depending upon the number of shareholders, Companies may also be advised to make necessary arrangements at various centers for registering the Votes of the shareholders.

A serious thinking is necessary on these issues. □

### Reduction of Capital of Company

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Further, de-mergers, i.e., division of a single entity into two or more entities also require being recognized and treated on par with mergers and acquisitions regime. Mergers and acquisitions are used as instruments of momentous business growth. The process may be initiated through common agreements between the two parties and sanction of High Court is required for bringing it into effect. Central Government has a role to play in this process and it acts through an Official Liquidator or Regional Director of the Ministry of Company Affairs. As per J. J. Irani Expert Committee Report, 2005, the scheme for reduction of capital simultaneously with the scheme for merger and acquisition should be avoided. The provisions relating to obtaining consent from unsecured creditors should be done away with. To ensure continuity of the existence of transferee company/ resulting company, the Committee felt the need to mandate the requirement of a satisfactory liquidity test and prescribed debt equity norms. Creditors consent needed only when companies are unable to meet the liquidity test. It is important to note that there is no legal impediment on reduction of share capital when it is a part of scheme of amalgamation. In such case procedure for reduction of capital has to be complied with.

### SOME SUGGESTIONS FOR IMPROVEMENT IN SCHEME OF REDUCTION OF CAPITAL

- It is a highly technical and long, cumbersome process. So there's a need to make it flexible and comprehensive.
- Company has to obtain a number of approvals and complete

administrative processes which entails expenditure as well as time and energy. So this process should be made more time-bound with introduction of concepts like deemed approval.

- The provisions in respect of approval by shareholders by special resolution, which is a time consuming process needs to be made more time bound. The management of company should become responsible to make the process of passing of resolution and filing for the approval expeditions.
- The provisions of the Act for penalizing the company and its officers for any non-compliance with the provisions or fraudulently inducing investment to be made by people in the company should be made stringent. There is an urgent need from the Revision of fines.
- MCA 21 e governance project, which envisages electronic filing of the documents and online filing of various forms, should be adopted.
- Access to online Investors Grievances Redressal System should be made.
- In order to give a say to each and every shareholder postal ballot system should be adopted to get the resolution passed by requesting shareholders to send their assent or dissent in writing on a postal ballot within 30 days period from date of posting of the letter must be adopted. [New Section 192 A] [ Companies Second Amendment Bill, 1999]. □