VOLUME 4 | ISSUE 4

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

SECURITIES REGULATION AND INVESTOR PROTECTION: A LEGAL ANALYSIS OF FINANCIAL MARKETS

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INTRODUCTION

During the last 2-3 years, capital market has emerged as a major source of finance for the Indian corporate sector, with the primary market having been accessed to a tune of over Rs.22,000 crores in 1993-94. In the secondary market segment, with 23 recognised stock exchanges operating in the country, the number of hsted companies thereon, their daily turnover, the market capitalisation, and so forth, have increased tremendously, also witnessing in the process a rapid enlargement of the investor population to around 40 millions. Investors, therefore, have come to constitute the nucleic segment of the capital market and the investment options available to them cover a wide range. Investors' protection thus assumes a much important role.

The Securities and Exchange Board of India (SEBI) has been established for the development and regulation of the capital market and it has also been entrusted with the responsibility of protecting the interests of the investors. The SEBI Act has given it a certain power which SEBI has utilised in the last couple of years primarily to address itself to the aspect of investors' greivances. In a short span of time, SEBI has tried to achieve this by adopting the twin role of development and regulation, taking into account the stage or development of the capital market in India. The regulatory measures taken by SEBI have been subservient to the needs of market development and enough to enforce the required degree of discipline and foster high standards of fairness and integrity of the market and thereby protecting the interests of the investors. As a result of this, SEBI has tried to provide to the investors reasonable protection of their rights and interests through adequate, accurate and authentic information.

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The objective of any economic activity is to promote the well-being and standard of living of the people, which depends on the distribution of income in terms of real goods and services in the economy. For the growth process in the economy, production plays a vital role. Production of output depends upon material inputs, human inputs and financial inputs. Material inputs are in the form of physical materials like raw materials, plant, machinery and buildings. Human inputs are in the form of labour and enterprise. Financial inputs are in the form of capital, cash and credit. The proper co-operation between human and material inputs subject to the easy availability of financial inputs promotes the growth process in the economy and thereby promotes the well-being and standard of living of the people. The financial inputs emanate from the capital market system. Trading in money and monetary assets constitute the activity in the capital markets and are referred to as the capital market system. Savings mobilisation and promotion of investment are functions of the stock and capital markets which are a part of the organised financial system in the country. In this context, it is essential to know the investment environment, opportunities, role of protective institutions to safeguard the interest of shareholders and debenture holders.

STOCK AND CAPITAL MARKET

The term ‘Capital Market” is used in the wider sense as to include both the new issues market and the stock market^ In this sense, both primary and secondary markets are covered here. The trading in the stock market is debt claims of a medium and long-term nature which can be classified into those of the Government sector and of the private sector. The securities of government are traded in the stock market as a separate component, called gilt-edged market. These securities include those of the Central and State Governments, local bodies, semi-government bodies and those gu^a'anteed by the Government. In this market, there are again three t3rpes of securities - short, medium and long-dated Government securities, depending on the maturity period. Another component of the stock market deals with trading in corporate securities such as equity shares, preference shares and debentures. Equities are shares of companies of the ovmership category. When these equities are floated to the public for the first time by the companies as shares, they constitute the new issues market, which is a component of the capital market and when the same securities are traded again and again as secondary items, they constitute secondary markets.

PRIMARY OR NEW ISSUE MARKET

The new issue market deals with the raising of fresh capital either for cash or for consideration other than cash by companies and encompasses all institutions dealing in the issue of fresh claims. The forms in which these claims are incurred are equity shares, preference shares, debentures, rights, bonds, deposits, miscellaneous loans and so forth. All the financial institutions in the capital market which contribute, underwrite or directly subscribe are part of the new issue market. Initial issues are those floated by new companies for the first time, while further issues are subsequent issues floated by the existing companies. Capital issues can also be classified as those given for cash, for exchange of technical know-how, exchange of shares of another company or exchange for any other services rendered by the agencies or promoters. The placement of the issues may be through (a) prospectus (b) ofier of sale (c)private placement and (d) rights issue.

SECONDARY MARKET

Already issued and listed securities are traded in the secondary stock market. Shares, debentures and other securities are traded in the stock market. Money flows in daily through the trading of these securities. Secondary market is one of the main segments of financial system of the country. Securities Contracts (Regulation) Act, 1956, regulates the stock exchanges in the country.

INVESTMENT ENVIRONMENT

The investment environment in India is easily the most congenial for individual investors. The capital market is fairly well-organised and growing fast too. There are government sponsored investment schemes, as well as private sector sponsored investment schemes, representing the true options of a mixed economy. First of all, the way through which an individual investor makes his investment can be classified into (I) Direct Investment and (II) Indirect Investment. A brief explanation of these two types is given below:-

I. DIRECT INVESTMENT

Under this, the investors directly participate in the investment process. They analyse the investment opportunities, select and manage. Example : Investing in common stock, preferred stock, bonds and real estate.

II. INDIRECT INVESTMENT

Indirect investments are of two types

a) **Voluntary Investments**

Here, the investor invests through investment companies and mutual funds. The saving accounts and other bank deposits are termed voluntary indirect investments wherein the deposits are utilised for further investments

b) **Mandatory Investments**

Many employed individuals are required to participate in certain group investments like pension plans and insurance plans. This type of compulsory investments are termed mandatory investments.

INVESTMENT OPPORTUNITIES

The Indian investor community is now offered a galore of investment avenues in order to satisfy their varied needs. There are provided with innumerable opportunities and schemes that differ widely in their time of maturity, rate of return, risk, liquidity and safety. Thus, the various avenues can be classified into the following categories:-

VARIABLE INCOME INVESTMENT AVENUES

A. EQUITY SHARES

Equity investment is a variable income investment option. Equity shares represent ownership in an enterprise; equity capital is thus risk capital. If a company does well, the investors are benefited, otherwise not.

Advantages of equity investment

(i) Capital appreciation

(ii) Issues of bonus shares

(iii) Apart from annual dividends, interim dividends are available to equity shareholders in prosperous years of the company.

(iv) Equity shareholders have the 'right to further shares' of the company.

(v) As an owner of the company, equity shareholders enjoy voting rights in general meetings of the company.

(vi) Equity shares of selected companies can be pledged as security for obtaining loans.

Limitations

(i) Market value of equity shares keep fluctuating; some moderately but others voilently.

(ii) There is no guarantee of super profit.

(iii) It poses much difficulties for upcountry investors.

(iv) Over subscription of new issues brings in problem of non-allotment of shares, delay in refunding application and lock-up of funds without any interest.

(v) Equity investment is not a one-shot affair, it demands continuous involvement.

(vi) Timing is critical both in buying and selling of shares.

(vii) Uncertain and changing policies of the Government cause considerable damage to the profitability of companies, and in turn affects the equity shareholders in the first place.

SUBSCRIPTION RIGHTS

A firm may sell additional securities to raise funds for expansion because retained earnings from its operations are insufficient. These additional securities may be bonds, preferred stock or common stock. If the additional securities offered are common stock, the company should offer first to existing stock holders are referred to as subscription rights. These rights present stockholders to maintain their proportional share ownership in the company by purchasing a percentage of new issue that equals the proportion they already hold.

STOCK PURCHASE WARRANTS

Warrants are very similar to rights except that they usually originate from the sale of bonds or preferred stock and have a life expectancy of many years. Like rights shares, warranty gives the owner, the privilege of buying additional shares of common stock in the company at predetermined price. The reason that rights and warrants are listed as speculative securites is that they can yield exceptional leverage potential[2].

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[2] Timothy E. Johnson, Investment Principles, Prentice Hall, New jersey, 1978, p.32.

LEGAL PROVISIONS MEANT FOR INVESTORS' PROTECTION

Sec 59 - deals vdth penalty for error in the issue of prospectus.

Sec 62 - has to do with civil liabilities for misstatement in the prospectus.

Sec 63 - spells out criminal liability for the misstatement in the prospectus.

Sec 68 - deals with penalty for fraudulently inducing persons to invest. (In the above cases, Department of Company affairs has to take action.)

Secs 73, 73(2A), 73(2B) -interest on delayed refund and penalty against defaulting companies.

Secs 73(1A), 73(2) - for listing of the securities of the company to be granted permission within 10 weeks of closing of subscription list.

Secs 58(A), 58(4)(9), 58(A)(10) - repayment of deposits in accordance with terms and conditions and right to approach Company Law Board. Sec 84 - issue of duplicate share certificates.

Secs 113, 113(2) - Company in normal circumstances delivers share / debenture certificates within 3 months of allotment with fine of Rs.500 for eveiy day of default.

Secs 111, 111(2), 111(3), 111(4) - Company to register transfer and deliver share/ debenture certificates within 3 months of allotment with fine of Rs.500 for every day of default.

SUGGESTIONS

As examined in detail in the paper of present research report, since, investors are the backbone of growth of capital market, need for investor's protection is of paramount importance. While designing the statutory measures meant for investors' protection, the following suggestions deserve immediate attention

1. Companies Act, 1956

a) Review of abridged prospectus is essential for investors' protection. It should contain the salient features of the complete prospectus. The lead manager or merchant banker may be required to include in his 'due diligence' certificate, a paragraph to the effect that the abridged version fairly sets out all the features of the complete prospectus.

b) The Sachar Committee's recommendations such as right to speak and the right to vote on show of hands to be extended to proxy holders shall be included in the new Company Law Bill.

c) Stringent conditions have to be made when the companies decide to enter the capital markets. For this purpose Company Law Board should have more powers to punish the companies for violating the provisions of the Companies Act, 1956.

d) As there is a lapse in the existing Companies Act, 1956 with regard to the issue of duplicate share certificates (as pointed in Chapter III of the present research report), necessary amendments should be made in the Companies Act in the provisions dealing with the allotment of shares to the public and issue of duplicate share certificate.

2. SEBI Act, 1992

a) The changing economic scenario, the major economic reforms and Hberalization measures initiated by the central government such as globahsation of Indian capital market all these will present enormous opportunities to the private and public sector companies to tap their requirements of resources. For this purpose, the SEBI should be given more powers to regulate the capital market.

b) In order to safeguard the interest of the investors, strict regulations should be made in the primary market operation such as pricing of premium issues, allotment of shares, adequate disclosure of information by the issuing companies and so forth.

c) SEBI should be given more powers to supervise effectively the secondary market operation like insider trading, operation of modified badla system, futures and options in order to safeguard the interests of the investors.

d) It is necessary for SEBI to take action against erring managements of the companies, so that investors' complaints against the issues or dealings in securities can be dealt with promptly and satisfactorily.

3. INVESTORS' SERVICES CENTER

In view of growing capital market activities, besides SEBI's investors' grievance center, investors' service center should also come out in required numbers to redress the grievances of investing community. Such centers, vested with appropriate powers, may be established, to look with sympathy and understanding the investors' problems. These centers may have the mandate to take effective and prompt actions, and also have an exclusive jurisdiction to deal with the woes of the investors.

CONCLUSION

The increased growth of investors, the proliferating investment opportunities, the changed economic pohcies and the new investment environment have necessiated investors' protection. In India, in the context of share markets witnessed of stock market scam, it is now clear that there miist be a closer regulation of share markets and thereby giving protection to the investors become necessary in various legislations. In this connection, a study has been undertaken to 'examine the ongoing trading activities both in primary market and secondary market in India. Even though specialized protective agencies such as Securities Exchange Board of India (SEBI), Company Law Board (CLB) and stock exchanges are in existence for investor's protection, it is considered that still they have to go a long way. The present study has been carried out with the main aim of examining the need for investors' protection, the effectiveness (or) otherwise of the statutory provisions incorporated in the Companies Act, 1956, Securities Contracts (Regulation) Act, 1956, and SEBI Act, 1992 dealing with the trading activities in the primaiy and secondary market, and the adequacies (or) otherwise of the legal provisions in these three statutes dealing with investors' protection.

At present in India, three different statutes, namely. Companies Act, 1956, Securities Contracts (Regulation) Act, 1956, and SEBI Act, 1992 regulate the trading activities in the stock markets both primary and secondary. The irregularities (or) limitations found in the primary market operation are in the pricing of premium issues as well as inadequate disclosure of information in the prospectus and over pricing of rights issues. The irregularities (or) limitations are also found in secondary market operation which are in the operation of modified 'Badla' system, as well as pessimism and lack of confidence among investors and the delay in the settlement of cash transactions. These irregularities (or) limitations found in the primary and secondary market trading activities could well be corrected by conferring the SEBI with more powers as in the line of suggestion made in the present report. The Present study has brought to sharp focus that there is slackness in the regulatory provisions in the two statutes, namely Companies Act, 1956 and SEBI

Act, 1992, especially in the legal provisions pertaining to the issue of duplicate share certificate and SEBI's guidehnes for the issue of shares. The procedural lapses in these statutes must be corrected £is suggested in this research report. Further, as suggested in the present report, the investors' service centres in the private sector may come up in adequate number (to redress the grievances of the investors) in order to supplement the functioning of investors' grievance cell of the SEBI.

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