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Succession and Success for Investors In Open Offers And Secondary Markets: Regulation, Apprehension And Motivation In Case Of Indian Stock Markets

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Abstract: *Among various investment alternatives available to the investors in the market today, open offers have definitely failed to sail through by being a medium for earning good returns. In the recent years, open offers have lost shine by being less preferable by the investors. Though, open offers provide opportunities to the investors to sell shares at offer prices which are often higher than the current existing market prices, open offers have failed to see the brighter side in India. Between years 2008-2014, 613 open offers were announced, of which, only a handful of companies(less than 10%) managed to get more than 90% of the proposed percentage of shares through open offers. Rights issues when compared to open offers are often perceived negatively in the market signaling the stock dilution and overvaluation of the stocks.The study finds that the main reasons attributing to this disinterest mainly might be due to various alternative options available to the investors in the secondary markets. The reasons found vary proportionally for short-term, long-term investors and in the case of arbitrageurs.Thus, the study tries to understand this phenomenon considering the backdrop of regulation and interest of investors in case of Indian stock markets.*
Keywords: *Open offers, Buy back, Rights Issues*

I. Introduction

In the area of investments, it is often observed that investors find difficulty in choosing the right diversified investments within their limitations of time and money. Right investment policy is measured by the success rate of their investments over a period of time measured by the rate of returns. Depending upon the time horizon (short term or long term), after considering the transaction costs, brokerage costs and taxation, one realizes the actual profits from his/her investments. On the other hand, often but not rarely, we do find companies/promoters/acquirer companies offering choices to investors to sell their shares. This time, the ball lies in the court of investors. Depending upon whether the decision to buy the shares is from either parent companies or promoters/acquiring firm/any third party other than the company, the method of acquisition is recognized by different names and varied procedures. If the shares are bought by the parent company from the shareholders, it is often referred to as Buybacks. The buybacks often result in the shares bought to be nullified and never used for trading on the stock exchange. The shares are often bought either to increase promoter holdings in the company especially when the shares are trading at lower cost or when company intends to give boost to its share prices by reducing the number of shares traded. Thus, if the company intends to buy back the shares it can do so through open market operations or by tender route. So depending upon whether the investor has held the shares for less than a year or more, taxes need to be paid. Usually securities transaction tax has to be paid and currently for long term capital gains, the taxes are nil. (if securities transaction tax is paid).

II. Open Offers and Buybacks

A slight but significant change lies between buybacks and open offers. Instead of companies making the decisions to buy back the shares, if promoter or corporate acquirers decide to increase their stake in the

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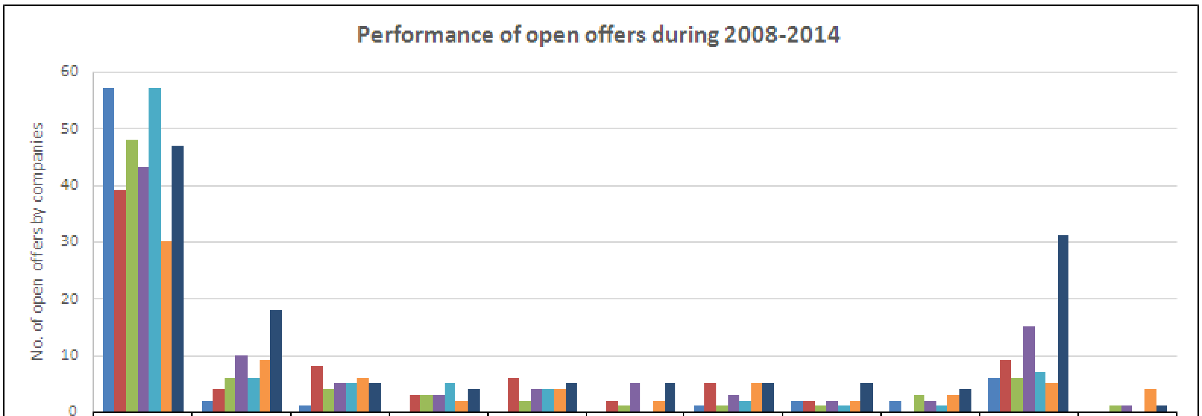
company, it is referred to as open offers. According to Securities and Exchange Board of India (SEBI) "Substantial Acquisition and Takeover code" it mandates stakeholders to come with open offers to buy shares from the shareholders, in case, the acquirer firm has atleast 25% stake in a listed company. Open offers are also mandatory, if stakeholder or promoter of the company with atleast 25% stake or voting rights in the company intends to increase the stake by atleast 5% in the singe financial year. Thus from open offers, the shares are transferred from shareholders to controlling stakeholder without resulting in any change in the number of outstanding shares. Thus, when compared to buybacks by the company which are voluntary in nature, open offers are mandatory and typically through tender route.

III. Open Offers in the Recent Times

In India, open offers though considered unique and special, are found to yield absolutely less returns and have rarely been successful. Considering the time period of six years from 2008 to 2014, Indian market witnessed 613 open offers. Among these 613 open offers, only 86 companies managed to acquire more than 90% proposed percentage of shares through open offers. Further, the companies managing to acquire 100% proposed percentage of shares through open offers is still meagre. To justify the numbers, in year 2008, only 23% of companies managed to acquire more than 90% proposed percentage of shares through open offers. These percentages havereduced to less than 10% during the years 2009-2014 as observed in Figure-1 and Figure-2 respectively.



	<=10	11-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100	>=100
2014	57	2	1	0	0	0	1	2	2	6	0
2013	39	4	8	3	6	2	5	2	0	9	0
2012	48	6	4	3	2	1	1	1	3	6	1
2011	43	10	5	3	4	5	3	2	2	15	1
2010	57	6	5	5	4	0	2	1	1	7	0
2009	30	9	6	2	4	2	5	2	3	5	4
2008	47	18	5	4	5	5	5	5	4	31	1

Acquired shares (% of proposed shares)
Source: Capitaline; compiled by Authors

Figure 1: Performance of open offers during the years 2008-2014.

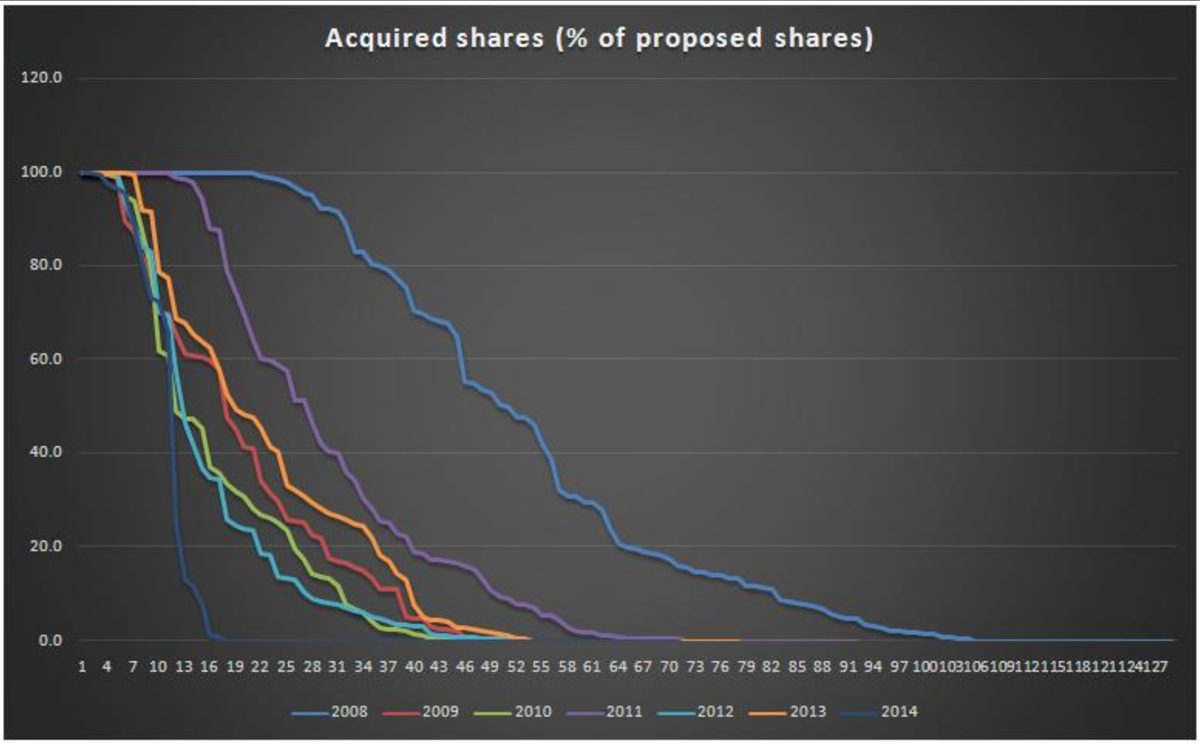


Figure 2: Acquired shares as a percentage of proposed shares for the period 2008-2014
Source: Capitaline.com; compiled by authors

IV. Reluctance Of The Investors Towards Open Offers In India

We know that, an open offer is a cash outflow activity from the point of view of the companies wherein the offer price is fixed based on the average price of the stock in the last 26 weeks. The offer prices are often seen to be higher than the prevailing market prices, which is always considered to be the motivating factor for the shareholders to participate. It is observed that, as soon as the offer price is announced, the stock prices rally beyond the offer prices. This lends an opportunity for investors to make short term profits. But, if the open offer fails, the shares are bound to fall, as the company would not make fresh open offer again. Thus, reluctance is shown from investors as secondary markets provide better alternatives to open offers. According to Stephens and Weisbach (1998) repurchase decisions by the firms are mainly based on their perceived undervaluation. These decisions are positively related to the levels of cash flow but negatively related to the stock price performances. Iqbal et.al (2009) tested the earnings management hypothesis by examining operating and return performance of UK open offers. They observed that the operating performance measures of the firms before the offer are significantly higher before bottoming out in the post-offer periods, which indicates temporarily inflating pre-offer earnings by the companies. Thus, the success or failure even in India should be tested from the point of view of study results obtained by Iqbal.et.al (2009). According to analysts, present taxation laws play a vital role in the success/failure of the open offers in India. Open offers according to present regulations are considered to be off-market deals between the private individuals, which would thus make taxation different from open market transactions. In case of open offers, there would not be any securities transaction tax(STT) of 0.1 percent on the share sale as it is considered as debt-market transaction. In case of secondary market transactions, the short-term capital gains tax on sale of shares or mutual funds is 15 percent and long-term capital gains tax is zero provided securities transaction tax is paid. Whereas, for the open offers, the short-term capital gains are taxed at 10 to 30 percent without considering education cess, based on investors tax slabs. For, long-term capital gains, investors are taxed at 10 percent without or 20 percent with an indexation benefit, whichever is lower. Thus, if the investors are in the lowest tax bracket, it would be beneficial to participate in open offers for short-term horizons. Whereas, for investors, who fall in the 20 and 30 percent tax brackets would lose out if they give the shares in the open offer because of higher rate of taxation on their income. Thus, selling the shares in the secondary market and paying 15 percent tax on gains would be beneficial rather than to enter in open offers. Considering long-term horizons, any long-term investments would be beneficial as the capital gains tax on equities is nil. Whereas, for open offers, capital gains would lead to higher taxation. Thus, considering this logical reasoning applied by every retail investors and large investors, it would be beneficial to go for selling the shares in the secondary markets.

V. Beneficiaries and Future Scope Of Research

According to performance of open offers in India, one can definitely consider taxation aspects to play a vital role. On the other hand, arbitrageurs can benefit from open offers by considering the acceptance ratios. If market performs in the same way as anticipated by arbitrageurs then they will gain by selling the shares in the open offers and hedging the risk by shorting the remaining shares. But, if the conditions are unfavorable and move away from the expectations, then arbitrageurs can be penalized by being left out with additional shares. Thus, though the number of studies in India on open offers are only handful in number, none of them consider earnings management hypothesis with respect to performances of the companies prior to the offer and post-offer. Thus, is perception towards open offers by investors and the market going to change?

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