Development of a Long-term Healthier Primary Equity Market

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State of the primary markets: The year 1999-2000 has been an exciting year for the investment banking community. With over Rs.8000 crore raised in the primary market, 46% through equity issues and 54% through debt, which would seem like an ideal mix and a balanced market. The primary capital market in India, particularly equity, had been languishing for the last four years. There was a marked drop in equity offerings, with the market being largely dominated by debt issues of Developmental Financial Institutions. It was being increasingly believed that the tribe of investors who invested in equity offerings was becoming extinct. But, these investors were back, shall we say, with a bang, with renewed interest in equity offerings. The markets were abuzz with activity , issues were getting oversubscribed and the "good" old days seemed to be back. The following table would give one an overview of the total funds raised and the proportion of debt and equity raised through Public Issues during the last two years.

	FY 1999	FY 2000
Number of issues	32	65
Total amount raised through Public Issues (Rs.crore)	7900	8160
Percentage of funds raised through debt issues (%)	93.63	54.46
Percentage of funds raised through equity issues (%)	6.37	45.54

However, during March 2000, there was a steep fall in the Sensex, somewhat reflecting what was happening on NASDAQ, which comprised heavily of technology stocks, putting the brakes on the excitement in our own capital market. As a result, a number of issues already lined up, are still waiting in the wings for a more acceptable climate so that they can realise their valuations.

- The market was largely dominated by issues from the information technology, media and pharma sectors. As regards the manufacturing sector, barring one large public issue from a packaging company, there was nothing to write home about. Thus, what we have seen is only a sectoral euphoria and there needs to be an overall development of the primary markets.
- What is also interesting to note is that the book building route was adopted by domestic issuers for the first time. There have now been 7 large offerings through the price discovery mechanism, which did exceedingly well in the markets. With the markets having fallen in the recent months, many such issuers have deferred their plans but they are definitely waiting for an opportune time.

Perhaps this is the time for us to reflect as to whether the primary markets are moving in the right direction; whether we are having a market that has a balance between equity and debt instruments, a market which has quality players and a market which aims to protect investor interest. Needless to add, the development of the primary markets cannot be viewed in isolation and is definitely linked to the growth of the economy as a whole. Improvement in market sentiments, which would give a boost to IPOs by corporates, would have to be fuelled by an overall growth in the economy. From a long-term perspective, economic and political environment has to be conducive to attract foreign investments. While some positive steps have been taken towards achieving a mature and healthy capital market environment, a lot more needs to be done.

Some positive measures taken:

- The book building route, which seems to have caught the fancy of software, media and entertainment issuers came under heavy scrutiny from SEBI and consequently there were a series of modifications in guidelines. SEBI now insists that issuers should collect uniform margins from various classes of investors. SEBI has also stipulated that demand for an issue at various price levels is made available to the public online for the benefit of the investors.
- Seeing the frantic pace of activity in the market, some unknown companies joined the bandwagon. These issues also received an overwhelming response. In fact, we hear of a few corporates, which have changed their names, giving an impression that they are into information technology. SEBI then had to intervene and stipulate that if a company changes its name thus, then it would need to have a track record of profitability for three years in IT activity to be able

to access the markets.

- Some companies are adopting the process of "reverse merger" to circumvent the entry norms prescribed by SEBI for unlisted companies. SEBI will have to look into this matter and take necessary steps to preclude these companies from accessing the markets and defrauding the retail investors.
- Stringent eligibility norms for companies, who wish to access the capital markets, have been prescribed by SEBI. SEBI has stipulated that the issuers should have had the ability to pay dividends in three out of the last five years. It has recently been stipulated that in case a company does not meet the above criteria, the book building route should be followed. In effect, for such companies, the market should determine the pricing of the issue. Moreover, 60% of the issue should be reserved for Qualified Institutional Buyers (QIBs). In case the Company does not receive investments to this extent from QIBs, the issue would fail. Such a step would certainly ensure quality issues and a realistic pricing of issues.
- Some companies, with the intention of rigging the share price, were issuing equity shares to market operators/other investors on a private placement basis before the public issue. SEBI has taken pre-emptive steps by disallowing issue of equity shares between filing the Offer Document with SEBI and listing of shares and also by prescribing a one year lock-in for the entire pre-issue equity capital of the Company.
- Disclosures regarding utilisation of issue proceeds on a regular basis have been made mandatory, thereby, making the issuers accountable for proper utilisation of funds. Besides, emphasis on prompt servicing of investors has also been made and certain steps have been taken in this direction, such as provision for a penal interest clause in case there is a delay in refund to investors. Very often, considerable time is taken to list the shares after the allotment is completed. Thus, the investors would not be able to trade in the shares for quite some time after allotment. It is now proposed to reduce the period of listing to 7 days from the date when allotment is finalised.
- Another positive measure is introduction of compulsory trading in demat for IPOs .
- Specific relaxations have been given to infrastructure companies, to facilitate public offerings from this sector. SEBI is also reducing the minimum public offer requirement for media companies.
- The number of merchant bankers engaged in issue management has been waning over the last few years. SEBI has also done away with the various categories of merchant bankers and now only Category I merchant bankers remain, thus reducing the number of players in this field. This would augur well for the market, as management of public issues requires the concerned merchant bankers to exercise due care and diligence and satisfy themselves about the credentials and genuineness of the issuer. The credibility of the merchant bankers too plays a very important role.

Other steps under consideration:

- With a view to cutting down the cost of a public issue and widening the reach with a cross-section of investors, SEBI is considering a proposal which would make an Initial Public Offer akin to a secondary market transaction. The issue would be made online through brokers registered with the Stock Exchanges.
- The possibility of participation by Provident Funds in the stock markets is being discussed. Even the BSE is considering allowing companies registered outside India to enlist their securities on the Exchange.

While many protective steps have been taken, it is also the responsibility of the investor to assess the issuer company, based on the information made available to him. Very often, investors have a herd mentality and investments are mainly done on the basis of "hearsay".

There is an onus on the merchant bankers to carry out a proper due diligence and provide complete and authentic information to the investors. The issuer companies should realise that it is in their long term interest to make full disclosures to the merchant bankers and the investors at large. In fact, many issuers wishing to tap the overseas markets are much more willing to part with full and complete information to the overseas investors. However, when it comes to tapping the domestic markets, they would rather adhere only to the prescribed statutory requirements. By their very definition, guidelines are meant to provide only a broad framework and it is for the issuer companies and merchant bankers to help investors to take an informed decision.

Thus, with the markets coming of age, merchant bankers and corporates would be required to play a very important role in ensuring that quality offerings are brought to the market. There needs to be a greater degree of accountability for the funds raised from investors. This change in the mindset should flow across the entire spectrum of the investment banking community, which would help us move towards a mature and healthy capital market environment.