Preventing Export of Indian Capital Market

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Indian Equity Capital Markets has had its most seminal period from the beginning of the year 2004. The largest book built equity transaction in India till end of 2003 was the nearly Rs.1,000 cr. IPO of Maruti Udyog Ltd. It was believed that the Indian markets did not have the depth to consummate global sized transactions i.e., upwards of US $ 500 m. However, in the year 2004 there were four mega-transactions successfully listed in India – those were the offerings from ONGC ($ 2.2 billion), ICICI Bank ($ 750 m), TCS ($ 1.2 billion) and NTPC ($ 1.2 billion). Each of these transactions was sold on a global basis and received high levels of subscription from all investor categories – retail, domestic institutions and global institutions. Another important development since early 2004 is the emergence of India in the international "Convertible Bond" market (known as FCCBs in India) – from a level of very little fund raising through this route till end of 2003, Indian companies has raised over $ 3 billion in convertible bonds since beginning of 2004 till date. In addition, there has been a number of ADR and GDR issuances especially since the beginning of 2005.

Thus Indian equity capital markets are today at a juncture where there is a vibrant and deep domestic market existing alongside an international market for both straight equity (ADR/GDRs) and convertible bonds. In this increasingly homogenized global market for equity capital, what are the challenges facing the key equity market participants in India? What structural steps can we adopt to meet most of the requirements of Indian companies through access to capital domestically, thereby minimizing the need to access international markets? After all, under the current framework, domestic investors, especially retail, have very limited opportunity to invest in international issues of Indian companies. And finally, what are the important pegs through which we can attract listing by international companies in India – if capital flows are global, then we should aim for our fair share of those flows.

Lets begin by examining the reasons why Indian companies raise capital abroad – the important considerations are access to deeper pools of capital especially through listing in USA; enhancing the profile of the issuer company overseas which may be important from a business perspective; access to a particular kind of investors who may be absent in the domestic market and hence by extension, access to newer forms of capital; and ease of process of raising capital.

It is well known that the deepest pool of capital exists in the United States of America. However, other markets, more particularly London and Singapore are increasingly vying to attract Indian companies to list in these markets, showcasing their respective investor pools. Our institutional investor market is more recent in relation to these markets and bulk of the international funds operating in India are emerging market focused. We should continue to encourage more international funds to register and invest in India and also explore the best way – keeping the market integrity intact – to enable hitherto prohibited asset managers like hedge funds to directly participate in our markets. Our endeavor over a period of time should be to narrow the current gap between the depth of capital markets overseas and our own.

Indian business is going global. The success of our software services industry is well documented and recognized globally. However, a number of other sectors are rising in importance in the global arena including those from pharmaceuticals, metals, auto and auto ancillaries, specialty chemicals to name a few. Often a substantial part of the revenue and operations of these companies are from overseas markets. Listing in overseas markets, particularly USA, imparts greater credence to these companies in their seeking out business opportunities in overseas markets. As more Indian businesses become global, there would continue to be a class of companies, which for 'strategic' reasons list overseas.

There are classes of investors who have not yet established themselves in India who provide access to Indian companies to forms of financing which are currently unavailable in India. The best example of this aspect is the emergence of the convertible bond market for Indian issuers – an investor class with no domestic equivalent presently. In order to retain this form of financing in India, it is important to actively encourage the establishment of this investor class in India through appropriate regulatory mechanisms. After all, upon conversion, convertible bonds are nothing but issue of equity eventually.

Time to market is a critical determinant of route to market – a longer drawn out process or a process that consumes inordinate amount of senior management time is less preferred to one, which is relatively expeditious. GDR issuances often (not ADRs) fit this description in relation to domestic offerings prompting many companies to go for GDR issuances. An important difference between a GDR and a domestic offering is the absence of a mandatory retail portion in the former, which facilitates faster execution. Developing regulations which facilitate placement of securities with Qualified Institutional Buyers (QIBs) can address this issue – currently, our regulations does not accord the same pricing freedom that overseas issuances enjoy and additionally constrains liquidity for any ‘private’ placement through a mandatory one year lock-in.

Simultaneous listing – offerings in the domestic and international markets simultaneously – are a standard feature of many markets. While in India this route has been explored, there are a few procedural hurdles under our current framework that inhibits this method of raising capital. These are the longer gap between close of issue and trading in India in relation to overseas markets; and potential of lower pricing in the Indian market on account of mandatory retail tranche. Improving on these aspects and facilitating simultaneous listings would benefit domestic investors and companies.

The increasing recognition of India’s manufacturing and services skills is leading to an unprecedented number of multinational firms establishing themselves in India. Attracting these companies to raise capital in India and list in India should be an area of increasing focus for us. Regulations governing Indian Depositary Receipts (IDRs) would help in accelerating this process. Multinational companies are not the only target constituents for IDRs – subsidiaries of many ‘Indian multinationals’, companies – especially in the technology services and pharmaceutical areas – operating overseas but with substantial business operations in India are all potential candidates for listing in our markets.

In summary, developing a deeper and more broad-based investor base, expediting the process of raising capital in India, developing a private placement market for equity and attracting foreign issuers to list in India would all lead to a more dynamic domestic market.