Reforms in Primary Debt Market - The Need of the Hour

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At the most basic level, a capital market has a primary market and a secondary market. A primary market is required as it enables issuers to get a diverse set of investors to invest in their projects. These issuers offer investors an opportunity to participate either as an owner by way of equity or as an investor by way of debt. The shares allotted to the investors may yield returns to them over a period of time depending on the performance of the company. However, apart from return on their investments, investors also need liquidity, which would enable them to sell their investments as and when they require to do so. In capital market parlance, this market is known as the secondary market.

In order to control the primary market, the Government passed the Capital Issues Control Act, 1955 and the Securities Contract (Regulation) Act in 1956. Thus all issuers of securities in the primary market during the period 1955 to 1992 required the Government's permission for the price, size and date (opening and closing) of the issue. In 1992, the Government of India created a separate statutory authority namely Securities and Exchange Board of India (SEBI) to regulate the capital markets and also repealed the Controller of Capital Issues Act. Thus, issuers were given the freedom in terms of price, size and launch of their issues.

After the Government of India ushered in reforms in 1991, the Indian economy has witnessed higher growth and the capital markets have leapfrogged in terms of traded volumes, market capitalization, reduction in settlement periods and the number of products on offer. Although the primary market is well developed for equities, it is still in a nascent stage for other instruments. In order to enable the economy to take full advantage of its primary market, a well developed primary market for all instruments is inevitable. For example, the primary market for bonds is still in a nascent stage. Most of the bond issues are privately placed by fund managers and merchant bankers and it is very difficult for a retail investor to acquire bonds. Further, the market for Municipal bonds is non existent, while the market for Government securities is dominated by primary dealers and banks.

In order to pan ahead it is essential that the shortcomings of the existing Primary market are studied. The main issues are:

A Instruments Covered by the Primary Market:

1. It exists only for equities. This is because the primary issuances of equity (may it be an initial public offering, a follow-on public offering, a sale of promoter/ dominant shareholder's stake to the public or disinvestment by government) is done through the Stock Exchanges.
2. Corporate financing is still an exclusive club with merchant bankers and fund managers as members.
3. The investors in auctions of Government securities are mostly primary dealers and banks.
4. A market for municipal bonds hardly exists.

B Procedures in the Primary Market:

1. Presently different procedures are followed for different instruments.
   - In the equity market and large issues of corporate bonds, the book building process through the Stock Exchange is followed.
   - The corporate and commercial paper issuances is through a network of the issue manager with deals between institutional investors and the manager.
   - The Government securities are sold through an auction process where the Primary dealers and Banks participate.

C Other issues:

1. The secondary market for papers other than equity is practically non existent.
2. Government Securities held in SGL accounts cannot be delivered on the stock exchange.
3. The deals are done over phone and their reporting to the Stock Exchange, FIMMDA and other entities is voluntary.
4. Price discovery and liquidity is lacking.
5. Retail investors are not aware of the investment opportunities and even how they can participate i.e. purchase these securities.
6. Retail investors do not have an exit option in most cases. A classic example is the Sardar Sarovar Bonds, which are long term investment and do not provide options for the retail investor.

Thus, the need of the hour is to introduce reforms which will increase the depth and the width of the primary markets and bring them in line with the Primary market for equities. This can be done by:

1. Educating investors on opportunities in all instruments so that they can take informed investment decisions.
2. Making it mandatory to list all issuances on the exchange and also permit trading in the same. Further, all fresh issuances should mandatorily be through the depositories.
3. A common platform to trade and transfer all types of securities should be made mandatory. This should be made applicable for Government securities also.
4. The two tier book entry mode of holding government securities through SGL accounts held by banks with RBI and each bank maintaining its own book for holdings of its customers should be replaced with the holding through the depositories.
5. Deliveries of securities to Clearing Corporation of India Ltd. (CCIL) should be permitted through the depositories only.

I am sure that with the increase in the number of products available to investors, India will see a more vibrant primary market with greater depth.