Emerging Trends in the IPO Market

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The capital market in any country is one of the core economic indicators and is, at any point of time, a reflection of the state of the economy. The importance and the pivotal role that the capital market environment plays, therefore, needs no emphasis, as evidenced by the degree of concern expressed by various players in the market on the state of the primary capital markets today. It is a fairly well known fact that the capital markets in India are going through a very subdued phase. The total number of Public Issues that hit the market in the year 1998-99 was 32, garnering about Rs.7000 crore as against 1343 issues aggregating over Rs.13000 crore in the year 1994-95. Out of the Rs. 7000 crore raised during 1998-99, nearly an amount of Rs.6500 crore was accounted for by debt issues by Developmental Financial Institutions; equity issuances aggregated a mere Rs.500 crore.

Comparative figures of **equity offerings** in the last five years are given hereunder:

Year	***Amount Raised (Rs. in crore)***
1994-95	13312
1995-96	8882
1996-97	4671
1997-98	1132
1998-99	504

The table above makes it amply evident that equity offerings are no longer a favourite with Indian investors. Over the years, there has been a paradigm shift towards fixed income securities and now, after the recent decision to make incomes from Mutual Funds tax-free, most Mutual Fund schemes are also drawing overwhelming response.

PAST TRENDS

In this context, it may perhaps be worthwhile for us to go into the past and analyse the market that prevailed then and get an insight into its psychology. This, in my view, would help us understand the reasons for the present state of affairs and also give us an insight into the future trends of the IPO market.

Pre-1992-93

- Controlled economy- Liberalisation had yet to spread its wings and the economy was a controlled one. Before setting up the Securities and Exchange Board of India, capital issues were under the control of the Controller of Capital Issues(CCI).
- Corporate performance was fairly satisfactory, as there was excess demand over supply in almost all markets, particularly commodities such as sugar, cement, steel, petrochemicals and automobiles. As these activities were capital-intensive, huge amount of funds was raised through public issues.
- Pricing in public issues had to be determined by the formula prescribed by CCI and was reasonable.
- There was a history of good stock market performance, particularly in the case of IPOs from well-known FERA companies.
- Investors were amply rewarded through capital appreciation in stocks.
- As a result, even greenfield projects generated considerable interest among the investing community, as investors generally took a long-term view on stocks.

1992-93 to 1994-95

- Liberalisation was introduced in the economy and import restrictions were gradually reduced. The Securities and Exchange Board of India (SEBI) was set up. The concept of pricing as per a pre-determined formula prescribed by CCI was done away with and a free pricing regime came into being.
- Industrialists and other financial intermediaries, perhaps, failed in their vision to comprehend the effect of liberalisation and continued the unabated expansion/ diversification spree without realising that excess capacities were being built up in the economy.
- Several fly-by-night operators also joined the bandwagon and capitalised on the bullish market sentiments.
- Investors too continued to flock in, without realising that excess capacities on account of fresh capacity build-up and imports may adversely affect the performance of such companies.
- On account of the then prevailing buoyant market, almost all issues received overwhelming responses. Investors also made handsome gains in the initial period of one to two years. However, as the performance of most of these companies could not meet the expectations of the investors

subsequently, the secondary market prices of such companies took a beating.

1995-96 onwards

- Most issuers were not able to keep up their financial performance in the later years.
- Investors had lost heavily on their investments and were keen to offload their holdings even at a loss, leading to huge floating stocks in the market.
- Investors shied away from equity investments and moved over to fixed income securities.

The change in investor psyche has, thus, been a result of the factors outlined above. While it may not be true to infer that IPOs would now become nearly-extinct and the debt market has come to stay, I rather think that there is a latent demand, which needs to be tapped. Of course, the issues need to be of very high quality and be reasonably priced from companies that perform well and reward investors adequately, in order to bring the retail investor back. At this stage, there appears to be a sufficient appetite for public offerings by reputed corporates where sector performance is likely to yield above-average returns, such as software and pharmaceuticals.

EMERGING TRENDS IN THE CAPITAL MARKET

The state of the capital markets today has been widely discussed and debated and the anxiety with respect to reviving and revitalising the markets is certainly understandable. However, in my view, we should not aim to go back to the markets of the years 1992-93 to 1993-94 , for that was a phase where every issue, irrespective of fundamentals, was oversubscribed; that was a market which failed to distinguish between quality and mediocrity. In fact, the kind of market that we need today, and should aim at, should satisfy the following conditions:

* Issuers are genuine with a proven track record or with a backing from a reputed Financial Institution/Bank
* Issues are priced reasonably
* Issuers are reasonable about their projections and future profitability
* Issuers are made accountable for utilisation of issue proceeds
* Investors are fully informed

Needless to add, there is no denying the fact that corporate governance has assumed a pivotal role and corporates need to be accountable for the moneys raised from the public.

With recent developments in the capital markets, it is expected that the retail interest would be gradually built up and we may hope to attain a balanced capital market, with a judicious mix of both equity and debt offerings.

- **Quality of issues**
  Stringent eligibility norms for companies, who wish to access the capital market, 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. Else, the project for which the funds are being raised, should be appraised by a Financial Institution/Scheduled Commercial Bank, which would participate atleast to the extent of 10% of the project cost, either by way of loan or equity. Such a step would certainly prevent mediocre companies from accessing the markets.

- **Greater transparency**
  Stricter disclosure norms in the offer document have been prescribed by SEBI, following the recommendations of the Malegam Committee. Issuers are now required to disclose financials after necessary adjustments, for giving effect to any material change in accounting policies or any qualification by Auditors in their Accounts. Further, the management of the company is also required to furnish their analysis regarding the financials of the company for the last three years. These measures would certainly lead to a market that is more mature, where investors would take informed investment decisions.

- **Greater acccountability on the part of issuers**
  Disclosures regarding utilisation of issue proceeds in the Annual Reports 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 refunds to investors.

- **Types of issuers likely to access the market**
  In view of present excess capacities in industry, Indian corporates will require to re-structure through Mergers & Amalgamations. The funding for these acquisitions should be encouraged through the capital markets. This will bring good blue chip offerings in the capital market.
  The coming years may see quite a few infrastructure projects being set up. The India Infrastructure Report brought out by the Rakesh Mohan Committee in the year 1996, has highlighted the following aspects:
  * Empirical evidence suggests that infrastructure projects, irrespective of their sectoral characteristics, have high leverage ratios and infrastructure firms typically fund projects through debt finance.
  * It is expected that the total funding requirements for infrastructure to be financed

from the domestic capital market would rise from the current Rs.25000 crores to Rs.42000 crores by 2000-01 and Rs.72000 crores by 2005-06.

* The Committee has recommended introduction of certain fiscal incentives for making investments in infrastructure attractive.

However, while the fund-requirements are substantial, the extent of resources that would be raised through the capital markets would depend on a lot of factors such as status of various projects, (i.e., whether financial closure is expected to be achieved in the next 2/3 years), tax incentives available, state of the capital market etc. Though SEBI has recently issued guidelines conferring certain concessions for public issues by infrastructure companies, the number of public issues by such companies would depend on the factors mentioned above.

Though most of fund raisings are expected to be either through private placements of equity/debt or through loans, there could be a few retail offerings with tax benefits.

The software sector has been the flavour of the market, as reflected by a bullish trend on the bourses. While most of the companies in this sector are cash-rich, a few software corporates are expected to tap the market. These would, however, be relatively small-sized IPOs.

- **Pricing in IPOs**

  Pricing in issues may have to be done more scientifically, taking into account the market perceptions and the earnings potential of the issuers. While the book-building route is a possible alternative, it may not be suited for pricing of an IPO, where substantial retail participation is envisaged. Unlike the Western countries, the Indian retail market is not sophisticated enough and is also not supported by adequate infrastructure for a book-building exercise in the pure sense. The book building route has been more successful in private placements with institutional investors.

- **Intermediaries**

  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 only Category I merchant bankers remain, thus reducing the number of players in this field. This would augur well for the market, for 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.

- **Buy-back of shares**

  Buy-back of shares has recently been permitted, though these may not emerge to be as popular in a growing economy like India as it is in the developed countries, as returning capital to the shareholders might not be an attractive option for most Indian corporates, who have capital expenditure plans on the anvil. However, we may see some activity on this front, though it will take time for this idea to mature and gain ground in India.

The development of the primary market cannot be viewed in isolation and is definitely linked to the growth of the economy as a whole. Thus, 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. Besides, our aggregate domestic savings are insufficient to fund our diverse investment needs. Most of the savings are of a short-term nature and can be channelised into key sectors such as infrastructure only to a limited extent. Efforts need to be made, therefore, to encourage institutions/ schemes that raise longer-term money such as insurance and pension funds. Further, there is an imperative need to make India an attractive destination for foreign investments for which, from a long-term perspective, economic and political environment has to be conducive.