

# Indian Primary Market – What Is The Need of The Hour?

## Streamlining IPO application and allotment process



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SEBI has been doing a yeoman's job in bringing about several changes in the procedure laid down for raising money from the public. The SEBI (Disclosure and Investor Protection) (DIP) Guidelines 2000 have undergone several changes each of which when made was necessitated, since it related to the then need, and requirement of the market. While all these have had the desired effect in the market, the one thing, which has been eluding SEBI's think tank, is the reduction in the time frame for listing of the securities post the closure of the bids. The news item which appeared in the Financial news papers on 20<sup>th</sup> May 2009 talks about the fact that SEBI is seized of this issue and would soon bring in several changes in the regulatory frame work whereby the time frame for IPO,s, Rights Issues, QIP would all be streamlined to make this possible. No doubt, we have come a long way from where we were in the early 80s and 90s. The time frame then for completing the process and listing the shares even for fixed price issues in the 80's and early 90's was nearly 70 days. This was brought down to 30 days in respect of fixed price issues in the mid nineties and later on to 15 days for book built issues. Although these time frames are for completion of the issue work which includes sending refunds and giving credit for the shares allotted there exists a further 7

working days period from the date of approval of the Basis of Allotment for the shares to be listed and traded. In effect the tcurrent time frame for the investor to have an exit route works out to nearly 22 days from the closure of the issue and there is no doubt this time frame needs to be reduced.

### BOOK BUILDING PROCESS

To move with the global trend of issuing shares through the Book Building process, the Book Building Guidelines was introduced in the year 1996. For various reasons not known to the Regulator none of the issuers adopted this practice of raising money through the Book Building route till the year 1999 when Hughes Software Ltd. came out with the issue through the Book Building route in the year 1999. In the initial stages most of the companies adopted the practice of raising money partly through the book-building route, which used to take up to 15 days and partly through the fixed price route, which used to take another 15 days. In other words the book-building route was restricted to QIB's and HNI's. The retail investors participated in the issue through the fixed price route based on the Issue price determined by the QIB's and HNI's. Since this route was not significantly advantageous over the fixed price route it soon lost its sheen and Issuers made way for raising money through 100% book building wherein all the three category of investors would participate simultaneously. The concept of raising money through the 100% Book Building route reduced the time frame for allotment and completion to 15 days from the closure of the bids with a further allowance of 7 working days to get the shares listed and traded from the date the Basis of allotment was approved by the Stock Exchanges. This in effect meant that the investor who had parked his funds in an IPO was able to get an exit option on or around the 22 calendar days from the closure of the bids. This in effect also meant that the issuer had access to the funds raised from on or around the 22<sup>nd</sup> day after closure of the bids. This, in comparison to raising money in the international market through ADRs, GDRs, and FCCBs etc., meant that time frame was nearly three to four times more in the domestic market. Book building exercise also gave a tremendous advantage to the QIB's since; in the initial period i.e. up to September 2005 they did not have to put in any margin money along with the bids. This prompted the QIB's especially the FII's to put in high value bids in IPO's.

The International Organization of Securities Commission (IOSCO) has nearly 30 odd parameters to judge the robustness of a Capital Market in any country. India is compliant in almost all barring a few like establishment of common Clearing Corporation for trades done in more than one Stock Exchange, Delivery v/s Payment, Listing period for IPO's etc.

### NOTIFICATION FOR CHANGES IN THE BOOK BUILDING GUIDELINES DATED 14<sup>TH</sup> AUGUST 2003

India has been able to achieve a settlement cycle of T+2 in the secondary market, indeed a far cry from what was happening in the early 80s and 90s, which was T+30 if not more. The Regulator has also been actively striving to bring about **Straight through Processing (STP)** for secondary market trades which if I may be permitted to say so, can be defined as "**Action initiated at one end resulting in the ultimate objective without any further manual intervention**". In fact in respect of institutional trades, STP is mandatory. The question therefore arises as to why

then we are not in a position to crunch the settlement cycle for an IPO from the existing T+22 to a period say T+10 or less. A detailed introspection into this question would reveal that the processes involved in the allocation of securities and the participation of the various intermediaries involved in the issue process needs to be re-jigged and revamped. The application form which seeks a host of information from the investors needs to be simplified and compacted to retain the absolute essentials or if I may say so the variables relating to the bids and all the other information can be obtained from the demographic details to be downloaded from the depository data base. A step in this direction has been made by SEBI by putting up a concept paper on its website in May 2009 seeking public opinion for making PAN as the sole identification of the investor. This I am sure will not receive any adverse comments from the intermediaries in the market and is expected to be soon notified by SEBI. It is not that this thought process has not crossed the mind of the Regulator. To be honest SEBI's first major initiative in this direction was provided by the notification of its Circular No. SEBI/CFD/DIL/DIP/Circular No. 11 dated August 14, 2003. SEBI in its endeavour to enhance the level of investors' protection and to increase the transparency and efficiency in the primary market, and with the intention to rationalize and simplify the various operational procedures changed the existing schedule no. XXI wherein the Book Building model time frame was sought to be brought down to T+6 as against the T+22, which was and is in vogue. Details of which is given below:-

T	T+1	T+2	T+3	T+4	T+5	T+6
Book Closed	<ul style="list-style-type: none"> <li>• Price Determination</li> <li>• Determination of offer size</li> </ul>	<ul style="list-style-type: none"> <li>• Registrar draws the allocation list</li> <li>• All entered bids assumed as valid</li> </ul>	<ul style="list-style-type: none"> <li>• Stock Exchanges approve the basis of allocation</li> <li>• Final prospectus printed and dispatched</li> <li>• CANs sent to QIBs</li> <li>• Allocation details electronically communicated by Registrar/Company to brokers</li> </ul>	<ul style="list-style-type: none"> <li>• Pay-in (Only high-value)</li> <li>• Bankers to confirm clearance of fund</li> <li>• Board Meeting</li> <li>• Stock Exchanges to issue the listing and trading permission</li> <li>• Company to instruct NSDL/CDSL to credit shares to the demat account of brokers</li> </ul>	<ul style="list-style-type: none"> <li>• Brokers account to be credited with shares</li> <li>• Broker to credit shares to the demat account of investors</li> </ul>	<ul style="list-style-type: none"> <li>• Trading commences</li> </ul>

The concept envisaged was to merge the e-IPO model, which was introduced in the DIP guidelines in the year 2000 (not acted upon by any Issuer) with the secondary market settlement for the shares to be allotted in an IPO. The market participants especially the Book Running Lead Managers and the Syndicate Members were not in favour of this concept since it was felt that the Indian market is not mature enough and more importantly investors with malafide intentions can take the market for a ride. It was felt by the intermediaries that a few unscrupulous investors can put in bids which will go awry thus resulting in the books being oversubscribed based on which the soft underwriting agreement is signed and due to lack of realization of the funds the financial burden would come on the BRLM and the Syndicate members. There was obviously some substance in their argument and therefore SEBI had to de-notify this portion of the Circular.

The table below gives the various intermediaries who are registered with SEBI in the country as of 31<sup>st</sup> Marc 2008:

Interestingly it will be noticed that there has been significant changes in certain numbers especially with those of the sub brokers, FII's, Merchant Bankers and Registrars. Not that, these changes was not without any reason. These changes signify the dynamics of the Indian primary market and the changing contours of the investing public and the regulatory changes which were brought about which impacted the market. This can be further substantiated by looking into the Table given below which gives a summary of the resources mobilized in the primary market through Public and Rights Issues through the years gone by.

SEBI Registered Market Intermediaries					
Market Intermediaries As on 31st March					
	1993	1998	2006	2008	2009
Stock Exchanges (Cash Market)	21	22	22	19	20
Stock Exchanges (Derivatives)	NA	NA	2	2	2
Brokers (Cash Segment)	5290	9005	9339	9464	9628
Corporate Brokers (Cash Segment)	NA	2976	3933	4138	4308
Sub-brokers (Cash Segment)	NA	3760	23479	41081	60947
Brokers (Derivative)	NA	NA	1120	1414	1587
Foreign Institutional Investors	18	496	882	1303	1626
Custodians	NA	NA	11	15	16
Depositories	NA	1	2	2	2
Depository Participants	NA	62	526	653	714
Merchant Bankers	74	802	130	151	134
Bankers to an Issue	NA	72	60	50	51
Underwriters	NA	43	57	35	19
Debenture Trustees	NA	32	32	28	30
Credit Rating Agencies	NA	NA	4	5	5
Venture Capital Funds	NA	NA	80	104	132
Foreign Venture Capital Investors	NA	NA	39	97	129
RTI and STA	NA	334	83	76	71
Portfolio Managers	28	16	132	201	232
Mutual Funds	NA	38	38	39	44
Collective Investment Schemes	NA	NA	0		
Approved Intermediaries (Stock Lending Schemes)	NA	1	3		3

NA: Not Available

Source SEBI Bulletin

#### Resources Mobilised from the Primary Market

Year	Total		Category-wise			
	No.	Amount	Public		Rights	
		Rs in Crores	No.	Amount	No.	Amount
			Public issues		Rights issues	
1993-94	1143	24372	773	15449	370	8923
1995-96	1725	20804	1426	14240	299	6564
1999-00	93	7817	65	6257	28	1560
2002-03	26	4070	14	3639	12	431
2003-04	57	23272	35	22265	22	1007
2004-05	60	28256	34	24640	26	3616
2005-06	139	27382	103	23294	36	4088
2006-07	124	33508	85	29797	39	3711
2007-08	124	87029	92	54511	32	32518
2008-09	46	14719	21	2082	25	12637

Source SEBI Bulletin

It can be noticed that in the year 1995-96 there were over 1700 issues and if one were to exclude Saturdays and Sundays it meant that there were more than six issues hitting the market every day. But the amount raised per issue was hardly around Rs. 12 crores. There was a lull in the market post 1996 till the year 2003-04. The primary market started becoming active from the said year thanks to the disinvestments policy of the then NDA Government when several Public Sector Undertakings including banks came out with IPO's. The first of the disinvestment through an IPO was in respect of 'Maruti Suzuki', which later on culminated in several such disinvestments like IPCL, CMC, GAIL ONGC etc. In line with this trend it will be noticed the average issue size jumped to over Rs. 400 crores in 2003-04. During the financial year 2007-08 the average size per issue was nearly Rs. 750 crores and for IPO's and FPO's the average was nearly Rs. 600 crores. With the UPA Govt. back in the saddle and with its avowed policy of disinvestment of the PSU's we can expect a host of mega Issues hitting the market in the near future. Money would

be required by the Govt. to meet the fiscal deficit arising out of popular measures announced but also to meet the infra structure development of the country which will call for huge resources and spending by the Govt.

### **SETTING UP OF SMILE COMMITTEE**

Despite the desire of the Regulator to crunch the time schedule in the primary market the processes involved would not permit them to do so. In March 2004 there was an event which is unheard off in the annals of a Capital Market in any country wherein due to immense pressure and the complexities of the processes involved, shares in a specific IPO namely (ONGC) was wrongly uploaded resulting in total chaos. This led the regulator to appoint a Committee to go into the various processes involved, and so to say to perform a 'health check' on the Securities market infrastructure encompassing all segments of the market. The Committee was rightly christened the "**Securities Market Infrastructure Leverage Expert Committee**" (**SMILE**) which was headed by Dr. P.J. Nayak as its Chairman with various luminaries from the market as its members. The Committee had several sittings with various intermediaries in the market to understand the process flow and to understand the reasons for the fiasco. The Committee in its recommendation suggested to revisit the earlier Notification issued by SEBI dated 14<sup>th</sup> August 2003 which with a few changes which Committee felt was warranted, could work as a panacea for the ills in the Primary Market. (**Refer SMILE Committee Report in the year 2004**) This also envisaged a drastic change in the processes, which would result in crunching the time frame for allotment to T+6 after closure. However for reasons not made public, the SMILE Committee recommendations were confined to the library and were never implemented.

In April 2006, Reliance Petroleum Ltd. hit the market and received a record number of applications exceeding 2.1 million. In the year 2008 another Company belonging to the Anil Ambani Group namely, Reliance Power received a record of more than 4.9 million applications. Worried with the increasing numbers of participation from the investing public and the fact that there has been mishaps in the past, especially where there has been large volumes and also the concern that the infrastructure of the market intermediaries could break down, the regulator constituted a Group named as "**Group for Review of Issuance Process**" (**GRIP**) to relook into the modalities with the intent and purpose of streamlining and simplifying the entire processes in an IPO and reduce the time frame in an allotment process so that the issuer can get access to the money raised and the investors to the securities and the refunds due to them, much earlier than they are used to. This group held its own internal discussions and also held discussions with market participants more specifically the Merchant Bankers, Escrow Bankers, Stock Exchanges, Registrar to issue, Investor Association etc. While it is not clear whether the group made any formal recommendations, SEBI in a master stroke came out with a revolutionary concept of marking the lien on the bank accounts of the investors, obviating the need for the investors to part with their money till allotment is finalized. A substantially improved version of the erstwhile stock invests. Marking lien on the funds proposed to be invested in an IPO is apparently the first step towards the journey to reduce the allotment process itself to 7 to 10 days from the closure of the issue / bidding period.

### **CONCEPT OF ASBA**

In this context, SEBI has come out with a concept paper, which was later notified, which provides for an *alternative* mode of payment in IPOs for the retail investors. This process talks about applications being received in an IPO, which is supported by amount to be blocked in the investors' account. This is a landmark announcement and is expected to provide immense relief to the investing public in the retail segment. **The 'Applications Supported by Blocked Amount' (ASBA)** process would however require the retail individual investors to bid only at 'cut off' price i.e. bid at the top end of the price band and submit the applications through Self Certified Syndicate Banks (SCSB). The SCSBs in turn are expected to do the following activities:-

### **ASBA PROCESS**

SCSB will accept the bid forms and capture the bid details essentially the variable being the number of shares bid, since the investor is expected to have a Bank account maintained with the said SCSB. Since KYC norms have already been fulfilled, the SCSBs would accept the bids and are required to verify the balance in the account maintained by the investor and block the amount to the extent to which the application has been made. The SCSBs thereafter either through their Designated Branches or through their controlling branches would upload the bids into the web enabled interface to be provided by the NSE and BSE, who in turn will reflect these bids to indicate the cumulative demand for the shares at any given point in time. The bid-cum-application forms will be initially retained by SCSBs and then forwarded to the Issuers. The SCSBs will be provided the facility to inform the Registrar of any withdrawals prior to the finalization of the allotment. In respect of the ASBA bids, the Registrar will not have to carry out any data entry but rely on the data uploaded by the SCSBs and proceed to finalize the basis with the Stock Exchange by including these bids. It is important to note that the normal process of bidding through syndicate members will also be available to all the categories of the investors including retail investors who do not choose to avail ASBA process irrespective of whether they bank with an SCSB.

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There are several advantages in this process to the retail investors, which are given below:-

#### **ADVANTAGES OF ASBA**

1. The investor does not have to issue a cheque
2. Money continues to lie in the investor account with the Bank thus allowing him to earn interest (The average amount invested by the retail investors is a little more than Rs. 40000/, which could mean the eligible investors choosing to avail ASBA process can earn an interest of Rs. 40 to 45 even at 3% rate of interest.
3. Bank will mark a lien on the application amount to the extent of the shares applied for by the investor.
4. Since no cheques are to be issued by the investor, there is no clearing involved.
5. Application submitted by the investor to the Bank will be duly validated and lien will be marked on the amount to the extent of application money payable.
6. In the event of allotment, amount will be released by the Bank only to the extent of shares allotted and transferred to the Issuers Account based on the instructions to be received from the Registrars.
7. There is no refund to be made and therefore there is no question of loss of instrument in transit or non-credit of electronic refund.
8. The issuer will save the expenditure on postage especially since all the physical refunds have to be mandatorily issued through Registered Post.
9. There will not be any chocking of the clearing system at RBI centres or any other bank which is undertaking clearing on behalf of RBI since, no cheques are to be issued by the investor nor any physical refund being issued to the investor. This was witnessed in the Reliance Power IPO where, in several centres the clearing bank had staggered the number of cheques to be presented in clearing to avoid choking of the system, which naturally resulted in delayed receipt of the application by the Registrars.
10. The time, effort and the problems that go into reconciling both at the bankers end and registrars end is avoided

It is a well-known fact that more than 99% of the retail investors invariably bid at cut off with single option. Since these bids are coming at the cut off price the retail investors do not participate in the price discovery. More importantly the volumes are coming in from the retail segment and if the processes for this segment is changed whereby their interaction is limited only with the bank that would be capturing the bids and blocking the funds, there would be no pressure on the other intermediaries, namely, Syndicate member and the Registrars. SEBI in its wisdom has also allowed those who do not want to go through the ASBA process to do it in the normal process by bidding through the Syndicate member. Since both the processes are going to run simultaneously, SEBI at this point in time has not visualized any reduction in the time frame for doing the allotment. Once the processes is tested and where there is more encouragement from the investing public in accepting this process there is bound to be a drastic change which ultimately will result in reduction in the time frame for allotment of securities in an IPO. SEBI would surely and eagerly be looking into the market participants reaction especially that of the retail investor. The time frame for allotment process remains at 15 days for completion and another 7 working days for listing.

#### **THE ROAD AHEAD FOR REDUCING TIME FRAME FOR ALLOTMENT**

In the context of the current process it is not out of place to mention that there is a lot of repetition of efforts put in amongst the intermediaries. The bid form seeks a whole lot of information from the investor making it a complex process. Multiple agencies capture the bid data leading to a waste of time which is avoidable. With PAN being made mandatory the investor would be required to give only the DP Id and Ben Id along with PAN with details of the bids. The issue price is invariably decided based on the electronic book and not the physical book which can be known only after the bids are processed. In such a scenario would it not be logical to consider the electronic book and take it to its logical conclusions for finalizing the list of allottees. If only a fool proof method is evolved where awry bids cannot enter the system or for that matter the amount in the investors account is blocked irrespective of the category to which the investor belongs too, before the bid is uploaded will ensure that all bids are indeed backed by money similar to the process being followed in ASBA, it will only assuage the fears raised by the BRLM and the Syndicate members thus leading to shortening the allotment process itself. With Core Banking Solutions (CBS) put in place by most of the Banks, both Public and Private the day is not far off when this would be a reality and trading in IPO,s could start within less than 10 days. The market participants would only be keen to be a part of this process since it will be a win win situation for both the investing public as well as the Issuers which, in the long run, is expected to provide a lot of benefits to the investing public. The process would definitely be a welcome change and should revolutionize the primary market in the country.

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