Primary Markets – Challenges in Distribution

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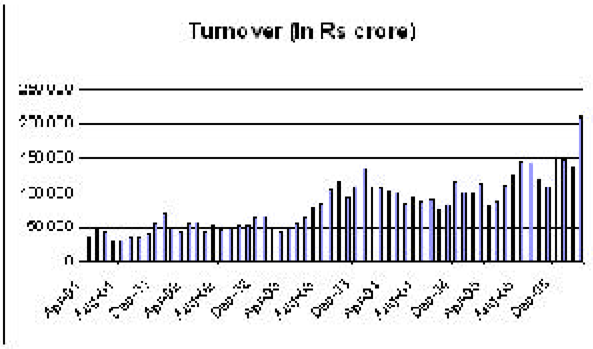
And the party ended with a bang this mid-summer as the markets gave full play to its hitherto well-hidden tempestuous tendencies and displayed all its glorious inconsisten-cies. After several small rumbles, the market first slumped on May 18, 2006 when Nifty closed down 246 points at 3388.9 and the meltdown on the following Monday was unbelievable! On May 22, 2006, trading was suspended on the indices (BSE Sensex/Nifty) and Nifty touched its lower circuit at the end of the morning session. On this day the Nifty closed down 5% at 3081. Intra-day it fell 10.7% to 2896.

The exaggerated exuberance driven by excess liquidity led to unsustainable leveraged positions in the Indian market. Also interest rates in the US have been steadily climbing up changing the risk return profile of India and finally triggered the fall in the market. At the first instance when the FII turned sellers the leveraged players could not match up to the selling, and ended in large scale correction.

Growth trend in Nifty

Source: IIL

Surge in market capitalization (NSE)
Turnover on NSE



Source: IIL

This was definitely not welcome and especially after the languorous complacency that had set in after an unprecedented growth phase in the markets wherein the indices jumped and how! The NSE witnessed a growth of 140% when it rose from 1560 on May 21, 2004 to 3754 on May 10, 2006. A similar quantum of growth would be reflected in the BSE Sensex.

We are not in any way saying that the run up was not justified. The positives were just too numerous that boded well for the market. The high growth rate in corporate profitability, the falling global interest rate scenario, and strong consumerisation story– be it retail or lifestyle, and an improving infrastructure including legal framework. All these were feeding the general positivity. A sustained 8% growth in the economy was just another silver lining. Clearly, the overbearing positives overlooked the steep valuations.

Primary Markets

In this scenario of plenty, even the primary markets had to take off. With the demand for equity rising and investors ready to give higher valuations it made economic sense for issuers to raise monies by way of equity as against debt

	2005-06		2004-05		2003-04		Total	
Issue	**No. of Issue**	**Total Issue Size (Rs. In Crores)**	**No. of Issue**	**Total Issue Size (Rs. In Crores)**	**No. of Issue**	**Total Issue Size (Rs. In Crores)**	**No. of Issue**	**Total Issue Size (Rs. In Crores)**
Book Building	71	22912.44	22	21362.72	15	16770.75	108	61045.91
Fixed Price	31	706.05	6	277.00	13	883.18	50	1352.03
Total	**102**	**23699.29**	**28**	**21640.52**	**28**	**17653.93**	**158**	**62998.74**

It is a general notion amongst the retail investors that primary markets are safer and a cheaper way of participating in the equity rally as one gets a perceived notion of safety from others participating in the issue. The surging markets have resulted in surprising windfalls for the primary market investors. In several instances, the investors have made more than 100% gains. But in these exuberant times the response received to an issue is driven more by herd mentality i.e. more applications attract greater applications and vice versa rather than on the valuation of the issure. Amount raised by way of IPO's in the past 3 years

Details of the performance of various issues in the recent times

Name of the issue	Issue Size (lakh shares)	Price Range	Issue Price	HNI	Retail	Overall	Total applns received	Listing Price
Reliance Petroleum Ltd	4500.00	Rs.57 to Rs 62	Rs.60	39.90	15.20	51.50	2108279	85.45
Godawari Power and Ispat Ltd.	86.95	Rs.70 to Rs 81	Rs.81	1.39	4.28	2.03	32586	103.15
Tantia Constructons Ltd.	43.50	Rs.45 to Rs 50	Rs.50	215.96	82.82	77.36	139825	220.00
Kewal Kiran Clothing Ltd.	31.00	Rs 260 to Rs.275	Rs 260	11.95	8.88	12.49	59331	247.25
Uttam Sugar Mills Ltd.	40.00	Rs.290 to Rs.340	Rs.340	1.45	4.36	4.63	44019	417.35
NITCO Tiles Ltd.	100.00	Rs.140 to Rs.168	Rs.168	2.87	2.58	4.57	34382	182.50
M & M Financial Services Ltd.	200.00	Rs.170 to Rs.200	Rs.200	42.95	10.13	26.94	263509	233.00
Gitanjali Gems Ltd.	170	Rs.170 to Rs.195	Rs.195	14.56	0.80	15.2	247087	167.15
INOX Leisure Ltd.	165.00	Rs.100 to Rs.120	Rs.120	92.31	17.75	49.59	303599	174.75
Jagran Prakashan Ltd.	100.30	Rs.270 to Rs.324	Rs.320	20.12	5.90	14.22	171876	260.05

Listing Price is the closing price on day of the listing

Performance of some of the recent issuances as given above put things in perspective that all IPO's carry the same market risk as any investment in the secondary market irrespective of the number of applications received or the price of offering. Now that the markets are volatile, most investors would have reduced their expectations in terms of profits. It should be kept in mind that all issues are fairly priced depending on the level of the markets then and no issuer would raise monies at a discount. Pricing of the issue is largely driven by sentiment at that point of time.

Most of the large high profile primary issues which hit the market at various levels of the Nifty in the last couple of years have done well and in conclusion we may say were fairly priced.

Name of Issuer	Date of listing	Issue Price	Listing Price	Current Price	Nifty then	Nifty
Reliance Petroleum	11 May 06	60	85.5	71	3701	3215
Suzlon	19-Oct-05	510	690.5	1008.8	2412	3215
TCS	24-Aug-04	850	987.5	1850.5	1951	3215
ONGC	29-Mar-04	750	844.5	1194.65	1762	3215
Maruti	09-Jul-03	125	164	791.3	1141	3215
Jet Airways	14-Mar-05	1100	1304	784.4	2147	3215

These statistics indicate that the markets accepted the pricing of these IPOs and their performance on listing is a testimony that the issue prices left enough on the table for the retail investors. While we believe that valuations of these stocks were reasonable when compared to corporate performance, the rise in stock prices are a reflection of sustained and improving corporate performance. However, in case of the airline industry represented by Jet Airways and Deccan Air, the story may be different, more a reflection of the global apathy towards airlines.

Challenges for a broker/distributor in a volatile market

In times of plenty, subscriptions to an initial public offering was just a function of bearing a risk for 20-days on part of the investor i.e. between applying for an issue and the issue getting listed.

The pricing of the primary issues in the erstwhile booming market had more to do with the positive momentum in the market rather than valuations of individual companies. All that the investor was doing in boom time was following the trend, there was not even a need felt to thoroughly read the prospectuses.

On the other hand, in a booming market the distributors' challenges were confined to the core distribution functions. The biggest challenges for a distribution business were limited to timelines as the entire process of IPOs – from issue opening to issue closing where subscription forms from all the three types of investors are to be collected and processed in a span of 15-days. The severe time constraints made it necessary that a broker had several channels to conduct business and widen reach. As the markets were on the upswing the call on the market was hardly a function of insight or judgment. It was rather following the herd in a bid to make money. But now that the market movements have turned volatile, is the value of the call going to matter.

With this change in the market reality, the role of a distributor would have to undergo a change. Taking into account the higher risk profile of the market, a successful distributor now would have to don an additional hat – that of an advisory.

An advisory role

In a volatile market, the role of a distributor is heightened as he turns advisor for the retailer. In its new avatar, the distributor may provide a detailed analysis of issues and re-iterate the risk profile of the company issuing fresh equity. In addition undertaking investor education camps would help to widen and deepen the investor base in the country. It may be noted that when Infosys IPO came in June 1993 it was not very received enthusiastically. However, with sustained corporate performance, Infosys has been able to overcome this bias and today is the market fancy. On the contrary in the case of Biocon IPO, while it was touted with much fanfare as India's first biotech company – the stock price has slipped even when the markets surged as the company's performance slipped vis-à-vis the expectations.

A checklist for the subscriber base: To better align to the current market realities

A research cum distributor house can help the retail investors to understand their own risk profile based on their existing asset allocation and financial requirements. It can also aid informed decision making by providing analysis in detail of the issue, the relative valuations of the issuer, and the expected time to return horizon of the investment as against the prevailing practice of most investors to flip the shares on the day of the listing. This will go a long way in getting equity investments its true place as an asset class and convert retail participants into true investors who invest in equity to grow their capital and not just make short term gains

Again the research outfit can help decide when to invest in a long and sustainable growth story or to buy into mature businesses as also the price levels for exit which plays a very important role in these volatile times.

Research houses can also help identify changing times as seen in the emergence of services/lifestyle sector IPOs. Be it the retail story as reflected by Shoppers' Stop, Pyramid Retail and Provogue or the multiplexes like INOX, PVR and Shringar. The valuations at which these IPOs were issued were at higher multiple to those of the manufacturing sector, justified by the higher growth prospects of the businesses that they are in. In the event of a global slowdown these life style sectors are expected to be fairly insulated. This would not have been possible earlier, but the changing outlook has made sure that the market is willing to look at different valuations.

Implications for an intermediary/distribution channel and do alliances hold the key to successful distribution

The bigger players in the distribution business are facing fierce competition while the smaller players are trying hard to stay on as technology, competition and corporatisation are re-writing the rules of the game. In addition, the severe time constraints have made it necessary that a broker has several channels to conduct business and widen reach.

Players are either expanding nationally or creating a niche for themselves. In addition, branding has become very important as firms try to cut through the clutter with the help of a differential. Smaller players have found it difficult to cope with the expenses of research, investor seminars, and aggressive advertising - things that are commonplace in today's broking business.

In this scenario, many on-the-brink brokers have traded independence to become a franchisee of an established broker. As aggressive branding by bigger and corporatised broking house is visible – this trend is intensifying. Their associations with big brands aid the small time distributors of equity in terms of credibility while clients get quality guidance, research and better service levels as set by the big players. Also, big brokers are getting aligned to several smaller brokers to form alliances to improve reach into specific regions whilst controlling costs. This distribution model based on alliances is immensely feasible due to the cut-throat competition and secondly due to the easy availability of brokers and sub-brokers aligned to the regional stock exchanges as franchisees.

These factors have altered the modalities of the distribution business in India. The big and branded brokers are best placed in terms of distribution to aggressively target high net worth individual who are offered personalised advisory and consultation services. These facilities are provided through relationship managers or online through the Net.

We are already seeing a change with brokerages transforming themselves into one-stop financial intermediaries trying to meet with the all round financial requirements of an individual. Gone are the days when even the retail investors invested in only bank fixed deposits. With the return on the deposit rates falling and with the increasing number of brokerages setting up their own offices or franchisees, the retail investor has become more aware of the increasing number of opportunity of investment avenues. It is here that he is looking for an advise. The market has already moved this way with a number of brokerage houses offering services ranging from broking to structuring of home loans to wealth management solutions and insurance products.