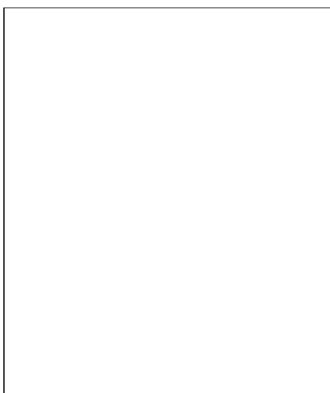
The Export of Indian Capital Markets



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As India integrates with the world it is natural for every aspect of business to develop umbilical chords with the rest of the world. The Indian capital market is no exception to this. Over the last few years the regulators have done a wonderful job in cleansing the market and improving efficiencies to bring it in line with other developed markets. The focus of the regulators was on secondary markets, trading, settlements, dematerialization and corporate governance of late.

The question of export of the capital markets had been raised in 1994-95 when the first wave of GDR issues took place. GDRs were then viewed as a more efficient way of raising equity because of a number of advantages such as ease of trading, settlement, market risk etc. Now the debate has once again been raised as companies access the US capital markets by listing on NASDAQ or the NYSE.

It may be interesting to study what kind of companies actually listed on the US exchanges and see whether there has indeed been an export of the market. In the last 18 months, about 9 companies have listed in the US markets. Of these only two companies namely Rediff and Satyam Infoway are not listed in India. Both these companies were not eligible for a listing in India according to the SEBI guidelines. Most other listings have been offerings by existing listed companies seeking a profile and currency for an overseas acquisition in the form of an ADR.

In the last two years, there was a period wherein companies explored a direct listing option in the US market, particularly amongst the IT companies. A US listing was very attractive since valuations were at stratospheric levels and the domestic market was perceived to be inefficient in raising equity. The turning point was the first Book Built IPO in India by Hughes software in September '99, which proved that equity could be raised efficiently and at attractive valuations in the Indian Market.

Credit must also go to the regulators who ensured that the Book Building guidelines were modified to enable a successful transaction. This prompted other companies to look at the local market and the regulators once again showed pragmatism in reducing the listing threshold to 10% - more in line with the US market.

Most companies do not fully understand the implications of a direct listing overseas without a local listing or what is called home market listings. Experience shows us that companies without a home market listing run the risk of being condemned as "Orphan Stocks" in larger markets, meaning, No one knows it, No one covers it (in research) and hence no one trades it!!

Most institutional investors like to have a view on a company from market intermediaries who are not syndicate members of a listing transaction. This gives them a balance of opinion about a company. A local listing prepares a company to face institutional investors and cope with the pressures of being a listed company in terms of managing expectations and interacting with institutional investors.

A number of companies have realized this and most are now planning a domestic listing followed by an overseas listing. Does this mean that the market is not getting exported? The answer is a definitive No! Lets look at some more statistics. When was the last time a major listed company raised further equity from the public in India? Even the Government divested GAIL and VSNL in the overseas market since these companies were listed in India without an offering to the public.

The Government has now facilitated a limited fungibility of the GDRs/ADRs and also allowed secondary sale of shares in the international markets, albeit with strings attached. This move carries with it the risk of sucking up liquidity in the domestic market. For e.g. If a company were to list in India by offering 10% of its capital to the public and thereafter, facilitates the shareholder to offer their shares as part of an overseas listing, it is possible that the floating stock in the local market will fall, resulting in an illiquid market. Interestingly, this aspect will be more pronounced in top quality well managed companies. While the fact that GDRs/ADRs can be converted to local stock can be touted as an argument, empirical evidence shows that very few of the GDRs/ADRs of Top quality companies have actually got converted to local shares. On the other hand, the GDRs/ADRs of companies with inconsistent performance and questionable credentials have invariably got converted to local shares.

Secondly, in the above example the "public" holding in the company will be below 10% if one excludes the shares, which may get converted to GDRs. This begs the question, whether the underlying shares representing GDRs/ADRs ought to qualify as "public"

holding in India. If yes, then the regulations for initial listing will have to be relaxed since it requires companies to make an offering through a prospectus and also ensure that it has a certain minimum number of shareholders. If the answer is no, ipso facto all GDRs/ADRs tantamount to private placement in which case, the pricing will get governed by the SEBI formula for private placement.

Neither of the above is desirable since it inhibits a company's freedom to raise capital in the most efficient manner possible and in the most efficient market. Indian companies should be allowed to list overseas to create brand equity, acquire a currency for acquisition overseas and also compensate global employees through a globally acceptable equity. While the relaxations of regulations are welcome, it should be prudently applied to adjust for inequalities in the two markets.

As long as currency convertibility restrictions are there, the regulations must ensure that

a. High quality companies must list in India and ensure a minimum trading stock in the local market.
b. Domestic listing should be a must.
c. Regulations to be amended to facilitate a smooth simultaneous offering of shares in the domestic and international offers