Emerging Trends in Indian IPOs

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The year 2006-07 was a landmark year in the history of the Indian Capital Market as it witnessed a total mobilization of almost **Rs.25, 000 crores;** to be precise a record of Rs. 24,993 crores! And to think in 2002-03 the market witnessed offerings of just around Rs.1039 crores, a jump of over 24 times in 4 years (source Prime Database). And this does not reckon capital raised by Indian Companies in overs-eas markets by way of FCCB/GDR/ ADR/SDR or similar instruments. The amount does not reflect the placement made under Qualified Institutional Buyers (QIP) route. Another interesting feature of the offerings made was predominantly by existing companies with a track record and in most cases with well known promoters. Significantly the year under review witnessed the largest IPO made in the history of the capital market; a single offering of over Rs. 5700 crores, which itself was larger by over 5 times of the total mobilization in 2002-03.

And when one looks back in history the Indian Capital has indeed grown phenomenally in the last few years. The author recalls in 1978-79 the office the (now defunct) Controller of Capital Issues (CCI) sanctioned offerings for equity for a total grand amount of Rs. 100 crores! And it was considered a milestone in the markets. Indeed we have come a long way from the days of the CCI and controlled pricing.

There are several factors which have contributed to this growth notable being the growth in the Indian Economy, large investments by companies in various spheres of business notably in Infrastructure, Telecom and Energy which requires huge capital. The boom in reality and retail sector has also been instrumental in several companies tapping the market for equity capital. The optimism and growth has propelled the requirements of capital. Of course the prime reason has been the buoyant state of the capital markets with the Sensex and Nifty scaling new heights. In addition more transparent disclosures overseen by the Regulator has also infused confidence amongst investors. The base of shareholders and investors has grown as will be evidenced by the lakhs of new Demat accounts being opened with NSDL and CDSL, the reach of intermediaries has increased in distribution, increased number of funds and FII participating in the Indian Capital Markets.

The outlook for the year 2007-08 appears even more bullish or maybe optimistic for the Capital market. As the author writes these few words, there are several companies planning to make offerings of capital to the investors and as it appears this year will witness maybe the largest offering (even larger the one made in 2006-07) and is likely to garner a sum in excess of Rs. 9000 crores . The amount planned to be raised in the first six months of the fiscal is likely to be more that was raised in the whole of the last fiscal! Estimates indicate a total market offering in excess of Rs. 70,000 crores, well nigh over two times raised in 2006-07. After some time gap PSU will raise capital from the market, including some Banks notably the largest Bank in India (in fact many banks will tap the capital markets during 2007-08, in preparation for compliance of Basel II norms).

So much for the immediate outlook of the capital market. The question which vexes many is will this sustain or will peter out after a few months? Will there be yet "quality offerings" of substantial size? Even if there are companies who have a track record and wish to raise huge amounts, will the Stock Market Bull Run continue to support the sentiment to garner investor response? Will regulatory measures drive companies to seek capital overseas? Will newer and more stringent entry norms be imposed to keep away several "smaller companies "from accessing public capital? Will new measures like "grading" of IPO and / or circuit filters on the day of listing work as road blocks for investor appetite and interest? Or will they as the regulators seem to believe, enhance the confidence of investors and "filter" the "quality"? These and many similar questions are being mulled over.

Despite such doubts and apprehensions, if the growth in GDP and huge investments envisaged the markets will continue to witness large offerings by companies in India. As in 2006-07, "quality "will be the benchmark for investor acceptance. As more International Funds look towards India, offerings will continue to subscribe. Newer investors are entering the Indian Capital Markets to buy shares of Indian Companies made on IPO or FPO's. **If the dream returns that IPO's gave on listing in 2006-07 continue, investor appetite and confidence is likely to sustain**. With several existing mutual funds making NFO's for various sectors and sizes, the availability of equity capital will continue to increase. Moreover new Asset Management companies are being planned and they too will raise funds from retail investors and would canalise and part of this in the IPO/ FPO segment. If the government pursues, despite some compulsions to do otherwise, disinvestment programme the market could witness larger and acceptable companies raising equity capital. One will recall that the disinvestment in Maruti Udyog is now considered to be

The Capital Market could even witness the sustained growth; maybe even grow at a faster pace, if the export of Capital Market is arrested. In the past we witnessed a large part of the market being exported, and this was for several reasons. Many of these have been addressed over the time and the outlook appears to give signals of more domestic offerings. Albeit Indian Companies will continue to seek capital and listing overseas but as many of these instruments being fungible will add to the float and hopefully a better market capitalization of the Indian Markets.

Some Pointers

The last few years and in particular the last fiscal witnessed the offerings being dominated by established company and many were part of large and known business houses. In particular the number of companies which raised capital in 2006-07, declined by 17% (from 102 to 85) thereby indicated larger offerings by bigger companies. In some manner this is augurs well that large Indian Companies have sought capital from the domestic markets. But it also demonstrates that "smaller" companies have not (or not been able or have not been encouraged) to raise capital.

There appear to be several reasons for this. A few come to the mind of the author:

- Regulatory provisions and entry barriers
- Initially grading which was voluntary was made to be followed only for small companies
- Deep suspicion of small companies (seems to be an overhang of the " vanishing companies of mid 1990's)
- The BIG two exchanges have their norms and hence a lack of exchange for small companies (not withstanding the fact that OTCEI was formed for small companies- but it is virtually non functional)
- Even "INDONEXT" hosted by BSE does not seem to have infused any enthusiasm in issuers or the Exchange itself.
- Some time ago Interconnected Stock Exchange of India (ISE) was created but it seems to have met the same fate as all other regional exchanges, lost some where in the annals of history of the market.
- Venture capitalists are hesitant to fund small companies in light of the fact they believe the exit route may take years to comply with entry norms, which may even been raised, hence making their investments ill liquid.
- The regulator now even believes "price manipulation "is prevalent only small issues (they wish to bring out a price band with circuit filters for trading on the listing day only for small companies).

The question then is small not good? Is a small company to remain small for ever?

There is an imminent and urgent need to have a dedicated exchange for small companies. History in the corporate world has been a witness of small companies having grown to "Giants" and respectable one at that! The glaring example that has quoted so often, been is that of Infosys. There are many such, like Dr. Reddy Laboratories, Apollo Hospitals, Ranbaxy and a host of others who command the respect and awe of the markets both in India and Overseas. None of these mentioned above and many more would be permitted to enter the capital market today, even if one were to give weightage to inflation and value of money then and now. Some of these barely raised a few crores as low as maybe a couple of crores and in some cases a few lakhs of Rupees. Indian entrepreneurs have been recognised and the fact they built companies and survived the "control regime of licensing "as also withstood the onslaught of overseas competition after liberalization in the early 1990's, is testimony to fact that small need not looked upon with suspicion. Ironically the government talks of encouraging Small and Medium Enterprises (SME) and several banks, including some International Banks present in India have carved out departments to give a special thrust to finance SME.

There is an inherent fear (to my mind wrongly placed) that small companies are managed by "dubious and incompetent" promoters who are either out to skim public money via an IPO and are not competent to manage the companies and hence are likely to mismanage the funds raised, if not downright fritter it away at the cost of the innocent investor! In this backdrop what the solution or a way out is for smaller (relatively) companies to be able access capital for growth. The scope exists in knowledge based industries, auto components sector, contract research in the pharmaceuticals industry, commercial education and a host of other segments. Several mutual funds have floated NFO to invest in SME, but will there any SME left in exist with listed shares on any exchange for them to invest in?

As stated earlier there is an imminent and urgent need for an exchange for such companies. Even the regulator has stated that a need does exist. There are ways to do and to let such an exchange do the rightful and necessary service and provide a platform to enable smaller companies seek capital, and enlist on such an exchange.

Some ways:

- Convert one the non functional exchange viz. OTCEI (who was given birth for such a precise segment and ironically it was the first electronic trading exchange of the country with nationwide connectivity) for such companies
- Move away companies listed on BSE (and maybe NSE) with a market capitalization of less than say Rs. 500 crores (or such figure which will define small companies) and permit the trading of such companies on the platform created by the exchange
- Lower entry barriers for such companies to be enlisted on such an exchange and permit them to raise public capital with appropriate safeguards and disclosures.
- Permit venture funded (by SEBI registered venture capital companies) companies to have their shares traded on such an exchange maybe even without an

IPO. This will impart liquidity and not entail huge costs associated with public offerings.

Some of these steps and encouragement will ensure more offerings on such an exchange, enable venture capital funding (which seems almost non existence, and to think the silicon valley success was because of venture capital who could then exit at an appropriate because NASDAQ was there to enlist such shares).

Other measures

Simplification of disclosure norms. Presently the offering documents are too technical and not even read by most investors, for who in the instance it has been written. The regulator, it is understood is working towards this.

Shelf prospectus: this could encourage and enable companies to seek public equity at an opportune time. Raising public capital is feasible when the markets are conducive and sentiments are bullish. Even a good company may not evoke response in a bear market, after no one takes a morning or evening walk when the streets of the city are flooded! Similarly no investor wishes to invest in a bear in fact the fact there are not sufficient buyers is the reason for a market to bearish! Companies can make their disclosures and update them when entering the market with a shelf prospectus registered with the Regulator and other bodies.

Conclusion

The stock market of India is much older than most stock markets of the world. It has a history and has had its share of grief, problems and scandals, for that matter which market of the world has not witnessed this? But it has a tradition which boasts, with a justifiable sense of pride of having evolved almost every system that the Anglo Saxon dominated markets have, and without even taking a leaf from their system. All that the exchange(s) in India lacked then was technology and that too was made available.

Indian Capital market from 1950 to 1992 was controlled by an office in the Ministry of Finance namely CCI. It sanctioned issues, decided on pricing and valuations and under priced shares to the immense benefit of investors. Even then companies did go belly up and many did not perform or maybe did not reward shareholders and investors, for several reasons. But the market grew and steadily with such small companies and offerings accepted by investors. Many of these grew then to good corporate citizens and followed good corporate governance, rewarded thousands of Indian retail investors and shareholders (there were no Mutual funds except UTI and no FII at all). Even in this era of control one company made an IPO of over Rs. 1000 crores in 1992 (almost equal to the entire IPO raising of 2002-03) and was heavily oversubscribed and garnered over 43 lakhs applicants and there were no Foreign Investors then only Indians and Non Resident Indians! And the IPO was to fund a Greenfield project with a gestation period of over 4 years.

With current trends and growth Indian Capital Markets should grow well over the next few years. As long Indian Economy and Indian companies grow, so will the capital market. Despite higher consumer spending, our savings rate is high enough to support a larger size of the capital. The Regulator now appears to have looked at many practical reforms in the capital market, and seems more receptive to changes which augur well for the market and all in it, the investor and intermediaries.

Views expressed in the article are solely those of the author and not necessarily organization where he works.