Challenges for Emerging Corporates in Raising Equity

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Equity plays a crucial role as an instrument to propel growth in any organisation. Let us take the case of a young entrepreneur who sets up a manufacturing unit in our country. First, there are the challenges associated with availing of the facilities granted by the Government. It is common knowledge that there are innumerable approvals and licences which are not so easy to obtain. By the time the unit is up and running, the promoter would have exhausted all his resources. The Banks would have supported with some term loan and working capital facilities. But, in the process, all the immovable properties of the promoter and his family would have been mortgaged to the bank by way of collateral. Aggressive Banks are known to take multiple times security cover in this process, which leaves the promoter gasping for fresh funds to fuel growth. This is the stage where most entrepreneurs start looking for outside equity, not only to fund growth, but also to set right the debt equity balance. This is the problem that is being attempted to be highlighted here.

So how was this problem addressed in the past?

Two decades back, State Industrial development Corporations and State financial Corporations used to participate in the equity of the project and share a part of the business risk. However, undue influences and incompetent promoters prompted Government policy makers to review the system, which eventually led to the decline of this system.

The early 1990s witnessed large number of Initial Public Offerings (IPOs) hitting the market, and raising Rs. 3 crores to 10 crores, using a 12 page prospectus, when Securities and Exchange Board of India (SEBI) was just being set up. That system of raising funds without adequate disclosures was stopped once SEBI formulated Disclosure and Investor Protection (DIP) guidelines governing the IPOs.

Thereafter, the size of IPOs increased along with added disclosures and larger investor participation. For most investors, IPOs have always been an opportunity to make listing gains and therefore the market practices always evolved to meet this basic requirement. As long as issues and the related pricing were relatively healthy, these market practices were not so serious in magnitude. Once greed went out of bounds, and stock prices crashed post listing, the Regulator proactively cracked the whip in 2011, and put an end to such practices. However, as a fallout, the basic criteria for raising capital on the main board were modified and it is now very difficult for companies with operating profits below Rs.15 crores to raise capital.

Maybe, some relaxations can be attempted in this context, like in case of Bank appraised and financed projects to raise capital on the main board. Secondly, fully underwritten issues (underwritten by SEBI registered entities like Brokers and Investment Bankers or Banks) may also be permitted, since pricing would be taken care of by consensus opinion of the underwriters. Since a very strong Surveillance and Market Intelligence system has been put in place by the Regulator and Stock Exchanges, possibly the above points can be revisited.

The SME platform was formed as an alternate option to raise capital for small companies where the eligibility criteria was substantially relaxed. More than 100 companies have raised capital using SME platform and many of these shares are quoting more than 5 to 10 times of their issue prices. However, such being the returns, more investors and corporates should have flocked to this platform in larger numbers. To strengthen this platform, if Mutual Funds and Alternate Investment Funds can be asked to set aside 5 % of their corpus to be invested only in these SME IPOs, then we could see healthy growth. We hope that this platform will mature and gain further momentum over a period of time.

An alternate way to raise equity other than IPO is through the private equity route (seed capital, venture funding, angel investing, growth capital etc.). When the concept started about 15 to 20 years back, there were quite a few venture capital players who participated in the equity of companies, starting from as low as Rs. 5 to 10 crores onwards. However, now there are very few venture capital funds and most of the funds have become private equity funds whose ticket size is $ 10 Million (Rs.60 crores) and above. This is because a large portfolio of small investments is very difficult to monitor, manage and generate returns. So Fund Managers would prefer to have a smaller portfolio with larger ticket size. So any deal size of upto Rs.50 crores find very limited takers. Add to this, the stringent term sheets of the Funds and companies would shy away, unless they are in a desperate situation or the term sheet conditions are substantially relaxed. Possibly, some incentives could be considered for setting up more Venture Capital Funds who cater to funding the smaller size equity requirements.

During 1970s and 1980s , Term Lending Institutions like IDBI, ICICI, IFCI and Investment Institutions like UTI,LIC and GIC used to have a standard clause in their sanction letters that 20% of the term loans sanctioned could be convertible into equity at par at the discretion of the lender. The logic was that if the company benefits from the debt support given by Institutions, then those Institutions should have an option to participate in the equity upside. One suggestion is that Banks which fund term loans and working capital requirements of companies should introduce this clause and use it as an option. This will help promoters who find it difficult to bring in equity during the initial growth phase, and also banks, who actually are in the best position to know their client and provide the much needed equity. Since the option would be used only in good corporates, this will help Banks build up a good equity portfolio over a period of time.

New concepts like crowd funding are yet to gain acceptability and momentum. There is a lot of equity funding happening in the space of new age technologies. But these are available mostly to a small bunch of technocrat entrepreneurs (IIT/IIM alumni) and funded by successful serial investors or successful Tech companies promoters. There is a huge appetite for these India centric opportunities from global investors and hence there is urgent need to create robust platforms where investors and entrepreneurs can meet. The Regulator has already taken cognisance of this and global investors could be attracted to invest, once regulations are in place.

The sincere attempt here is to suggest few possibilities to ensure that emerging corporates have access to a wide source of equity funds.