What Factors are involved in "starting up" a stock market listing

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Many years ago companies elected to list because the public markets were the biggest source of capital and the risk of the business would be shared by multiple shareholders. In recent times, as the Unicorns (companies with an enterprise value greater than $1 billion) in US, China and India have shown, the width and depth of the global private equity system has been able to support their capital needs for a lot longer.

This global trend has also captured Indian start-ups, particularly those in the technology field, to stay private (and unlisted) for longer. In the same way that Airbnb, Uber, SpaceX and Palantir in the United States and Ant Financial, Didi Chuxing and Aliyun in China have remained unlisted, Indian companies too have been able to secure funding and remain private. Flipkart (recently acquired by Walmart), Ola, Paytm and Hike have been able to raise several rounds of financing delaying the need for an IPO for the purpose of fund-raising. Venture capital firms that have entered these firms in Series A or B have been able to exit in Series D or E obviating the need for a listing from their point of view. These Unicorns have preferred to remain private to restrict their share-holding to a few professional investors and not become subject to the quarterly numbers game of the stock markets. New Indian companies like Zomato and Swiggy (food and logistics) are joining the earlier wave of companies (e-commerce and shared transportation). After a long period as a private firm, a few unicorns have chosen to list like Alibaba, Facebook, Xiaomi, Twitter and Spotify (direct listing).

Of course this dialogue is mostly limited to technology and technology enabled companies. Most other sectors do not have the flexibility of securing large amounts of capital and so the IPO route as a strategy is an important one. Beyond the need for capital, there are many factors that determine whether a company should list and if it elects to do so whether it can list.

Real Returns

Indian stock market returns in calendar 2017 were excellent – just shy of 30% for the broad stock market. Individual stocks and sectors did even better with mid-caps doing particularly well for the year. Over the last 2.5 years stock markets in India have risen at annualized pace of about 15%. This is par for the course for India over longer periods of time with most rolling 3 and 5 year period returns averaging 14-17% in rupee terms since the reforms of 1991, now nearly 27 years old. In real terms, this has meant that stocks have provided a real return of nearly 10% over long periods of time. High average real returns to stocks is one prerequisite for secondary market interest in stocks and in turn it is this interest that drives at least one of the factors influencing whether to list. For promoters and private equity funds, advised by investment banks, the real return to stocks is one important determinant of whether the IPO route is a viable path to liquidity. India scores well on this dimension.

Scale

Another important dimension is profits and scale. Beyond the technical eligibility requirements for profits on some of our exchanges, the marketplace requires a certain scale of equity market capitalization and a certain available daily trading volume to be successful. Even though profit margins for many companies are attractive, the total quantum of profits for many of the companies that seek to list in India is surprisingly sub-scale by global standards. Indian companies often try to list at an enterprise value of about Rs. 2,000 or Rs. 3000 Crores -- $300 to 400 million. At a float of 25% this leaves very little daily trading volume. If you leave out financial services and some of the industrials (petrochemicals and oil & gas) Indian companies are small by global standards. This situation arises because the market size for the products and services of these companies often hits a plateau. As India's per capita GDP rises from the $2000 level to $3000 and beyond this situation will change, but for now profits and scale in many sectors remains a challenge.

Preparation

In addition to external factors impacting the decision to list there are internal factors too. Start-ups generally grow in size and scale because they are agile and resourceful. That very strength can turn to weakness because the underlying processes and systematism that both the market regulator and the markets require are not fully in place. Good preparation for listing begins with putting in place risk management systems and processes that ensure the appropriate controls that would make a wide share-holding base comfortable. The first requirement is to have credible statutory accounting done by a reputable firm and to have internal audit arrangements in place. The markets regulators

have elaborate checklists that the lead banks in the IPOs ensure is satisfied. These checklists span legal, administrative, financial and secretarial issues. The most important requirement is to have a management team and Board that will give confidence to the market that the company is being governed and managed properly. Companies seeking to list should approach it as a "transformational" event rather than merely a financial event. In simple terms, an IPO should encourage start-ups to become "well-run companies" not merely financially attractive companies. Many start-ups stumble on this as they are not coached to think of the IPO as an important evolutionary step rather than an "end in itself". The post listing performance of a stock is determined by research coverage, and some amount of preparation should go into securing adequate coverage for the stock.

In real life situations many other factors may influence the listing process. Sometimes, the various venture capital and private equity firms that are part of the capital structure of the firm have differing objectives and time horizons. If the preparation is not adequate and the advice not incisive, sometimes, an IPO has to be withdrawn because it does not attract enough investors. Disagreements between founders or divorce in the case of husband and wife founding teams can set back plans for years. Timing is considered to be a major factor in listing but most seasoned market participants will say that for a good company you should be able to list in most markets.

For those start-ups that are on the track of size, scale and interest to be listed the best route to listing is to be prepared. India is becoming a good market for listing. Recent tightening of regulatory standards ensure that only good quality companies come to market. This, in turn, ensures that listings perform well which adds to the attractiveness of the IPO path. The old worry in the private equity industry was that you can get into an Indian company but you can rarely get out. That worry is being put to rest with a robust IPO market, good preparation and attractive long term real returns.

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