Primary Market

Introduction

Capital formation is an important ingredient for economic development of any country. Entrepreneurs require capital resources to convert ideas into products and services. Resources are mobilized by issuers of securities (government and corporates) through primary market, which provides a link between the savings and the investments across the entities. The issuers of securities, Government as well as corporate raise resources to meet their requirements by issuing/creating fresh securities in exchange of funds either through public issues and/or as private placement. When equity shares are exclusively offered to the existing shareholders, it is called "Rights Issue" and when it is issued to selected mature and sophisticated institutional investors as opposed to general public it is called "Private Placement Issues". Issuers may issue the securities at face value, or at a discount/premium and these securities may take a variety of forms such as equity, debt or some hybrid instrument. The issuers may issue the securities in domestic market and/or international market through ADR/GDR/ECB route. This chapter presents developments in primary market for corporate securities in India, both equity and debt, while the primary market for government securities is discussed in Chapter 6.

During 2002-03, a total of Rs. 2,520,179 million were mobilized by the government and the corporate sector from the primary market through public issues and private placement. Data in Table 2-1 is compiled based on RBI data, whereas detailed analysis of the various other facets of public issues and private placement by corporates is based on data from SEBI and Prime Database.

Table 2-1: Resource Mobilisation by Government and Corporate Sector

(Rs. mn.)

Issues	2001-02	2002-03
Corporate Securities	**744,032**	**700,389**
Domestic Issues	720,612	666,125
Public Issues	71,117	48,667
Non-Govt. Public Companies	56,922	18,777
PSU Bonds	—	—
Govt. Companies	3,500	—
Banks & FIs	10,695	29,890
Private Placement	649,495	617,458
Euro Issues	23,420	34,264
Government Securities	**1,525,080**	**1,819,790**
Central Government	1,338,010	1,511,260
State Governments	187,070	308,530
Total	**2,269,112**	**2,520,179**

Source: RBI.

There has been mixed response to the public issues of corporate securities in India during last few years due to reasons like prolonged subdued secondary market, IT sector melt down, etc. The corporate sector is finding it more attractive to mobilise funds from the private placement market, which provides them flexibility in terms of time and cost involved in raising funds and is less rigourously regulated than public issues market. The private placement dominated the primary corporate market, accounting for over 88% of total resources mobilised domestically by non-government entities. Corporate entities mobilised Rs. 48,667 million and Rs. 617,458 million during 2002-03 through the public issues and private placement respectively. The public sector entities accounted for about 56% of total resource mobilisation by way of private placements, while private corporate sector accounted for more than 80% of the total resource mobilisation by way of public issues. Thus, the private placement is dominated by the public sector entities and public issues by private corporate entities. The government raised Rs. 1,819,790 million from the primary market in 2002-03 to meet its requirements, the detailed analysis of which is given in Chapter 6. If the amounts raised through private placement, public and rights issues, and government securities are added, the resources raised during 2002-03 are fairly high, contrary to the prevailing perception that the resource mobilization through securities market has declined.

Policy Developments

Various measures were initiated by the Government, RBI and SEBI during the year to further refine the market design of the primary market and boost the market sentiments. Measures initiated during the April 2002 to June 2003 are detailed below:

DIP Guidelines

Accepting the recommendations made by the Joint Parliamentary Committee probing into the stock market scam and the Malegam Committee set up to consider the disclosure norms, SEBI amended the SEBI (Disclosure and Investor Protection) guidelines, 2000 to provide for the following:

i. Shares held by the person other than the promoters, prior to IPO which are locked-in may be transferred to any other person holding shares which are locked-in subject to continuation of lock-in in the hands of transferees for the remaining period and SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

ii. Shares held by promoter(s) which are locked-in may be transferred to and amongst promoter/promoter group or to a new promoter or persons in control of the company subject to continuation of lock-in in the hands of transferees for the remaining period and compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

iii. The draft offer document and the final offer document shall be approved by the Board of Directors of the issuer company and signed by all the Directors (including the managing director), Chief Executive Officer and Chief Financial Officer of the issuer company. They shall also certify that all the disclosures made in the offer document are true and correct.

iv. Some information have to be disclosed for all the issues irrespective of the issue prices *viz.,* Earnings per share, EPS pre-issue for the last three years, P/E pre issue, average return on net worth in the last 3 years, minimum return on increased net worth required to maintain pre-issue EPS, NAV per share based on last balance sheet, NAV per share after issue and comparison thereof with the issue price, comparison of all the accounting ratios of the issuer company, *provided* that the projected earnings shall not be used as a justification for the issue price in the offer document and further that the accounting ratios disclosed in the offer documents in support of basis of the issue price shall be calculated after giving effect to the consequent increase in capital on account of compulsory conversions outstanding as well as on the assumption that the options outstanding, if any, to subscribe for additional capital will be exercised.

v. The locked in shares/instruments may be transferred to and amongst promoter/promoter group or to a new promoter(s) or person(s) in control of the company, subject to continuation of locked-in in the hands of the transferee(s) for the remaining period and compliance of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

vi. Provide a provision for granting exemption by the Board regarding any particular provision(s) of these guidelines *viz.,* (i) on an application made by any listed company or intermediary connected with the issue, (ii) of a technical violation or a possible violation, or (iii) on being satisfied that the violation was caused or may be caused due to factors beyond the control of the applicant.

Debenture Redemption Reserve

The Section 117C of the Companies Act, 1956 contemplates the creation of security and liquidity to ensure timely repayment by companies on redemption of debentures and thereby afford protection to the debenture holders. It requires every company to create a Debenture Redemption Reserve (DRR) to which 'adequate amounts' shall be credited out of its 'profits' every year until such debentures are redeemed, and shall utilise the same exclusively for redemption of a particular set or series of debentures only. The Department of Company Affairs issued following clarifications in this regard:

a. No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by RBI and banking companies for both public as well as privately placed debentures.

b. For other FIs and for NBFCs registered with RBI, the adequacy of DRR will be 50% of the value of debentures issued through public issue and no DRR would be required in the case of privately placed debentures.

c. For manufacturing and infrastructure companies, the adequacy of DRR would be 50% of the value of debentures issued through public issue and 25% for privately placed debentures.

d. Section 117C of the Companies Act would apply to debentures issued and pending to be redeemed and as such DRR is required to be created for debentures issued prior to December 13, 2000.

e. Section 117C would also apply to non-convertible portion of debentures issued whether they are fully or partly convertible.

f. For Housing companies registered with national housing bank under Housing finance Companies Directions, 2001, "the adequacy" of Debenture Redemption Reserve (DRR) will be 50% of the value of debentures issued through public issues and no DRR is required in the case of privately placed debentures.

Underwriting by Merchant Banking Subsidiaries of Commercial Banks

In order to provide a level playing field to the merchant banking subsidiaries of banks, RBI decided that in partial modification of the earlier guidelines, the existing ceiling on underwriting commitments prescribed therein would not be applicable to merchant banking subsidiaries of banks. The merchant banking subsidiaries of banks regulated by SEBI would, consequently, be governed by the norms on the various aspects of the underwriting exercise taken up by them. The prudential exposure ceiling on underwriting and similar commitments of banks, however, remain unchanged and they shall be continued to be reckoned within the norms prescribed by RBI earlier on overall single borrower/issue size limits from time to time. Banks should also ensure continued viability of their merchant banking subsidiaries through periodic reviews of their performance. Other prudential norms on capital market exposure, asset-liability management, allocation of additional capital for risk weighted assets of the subsidiaries will also continue to apply.

Market Design

The market design for primary market is provided in the provision of the Companies Act, 1956, which deals with issues, listing and allotment of securities. In addition, DIP guidelines issued under securities laws by SEBI prescribe a series of disclosures norms to be complied about by issuer, promoter, management, project, risk factors and eligibility norms for accessing the market. However, in this section, the market design as provided in securities laws has been discussed.

DIP Guidelines, 2000

The issues of capital to public by Indian companies are governed by the Disclosure and Investor Protection (DIP) Guidelines of SEBI, which were issued in June 1992. SEBI has been issuing clarifications to these guidelines from time to time aiming at streamlining the public issue process. In order to provide a comprehensive coverage of all DIP guidelines, SEBI issued a compendium series in January 2000, known as SEBI (DIP) Guidelines, 2000. The guidelines provide norms relating to eligibility for companies issuing securities, pricing of issues listing requirements, disclosure norms, lock-in period for promoters' contribution, contents of offer documents, pre-and post-issue obligations, etc. The guidelines apply to all public issues, offers for sale and rights issues by listed and unlisted companies.

Eligibility Norms

Any company issuing securities through the offer document has to satisfy the following conditions:

- A company making a public issue of securities has to file a draft prospectus with SEBI, through an eligible merchant banker, at least 21 days prior to the filing of prospectus with the Registrar of Companies (ROCs). The filing of offer document is mandatory for a listed company issuing security through a rights issue where the aggregate value of securities, including premium, if any, exceeds Rs. 50 lakh. A company cannot make a public issue unless it has made an application for listing of those securities with stock exchange(s). The company must also have entered into an agreement with the depository for dematerialisation of its securities and also the company should have given an option to subscribers/shareholders/investors to receive the security certificates or securities in dematerialised form with the depository. A company cannot make an issue if the company has been prohibited from accessing the capital market under any order or discretion passed by SEBI.

- An unlisted company can make public issue of equity shares or any other security convertible into equity shares, on fixed price basis or on book building basis, provided (i) it has a pre-issue net worth of not less than Rs. 1 crore in 3 out of the 5 preceding years and has minimum net worth in immediately preceding two years, (ii) it has a track record of distributable profits in terms of section 205 of the Companies Act, 1956, for at least 3 out of the preceding 5 years, and (iii) the issue size (offer through offer document *plus* firm allotment *plus* promoters contribution through the offer document) does not exceed five times its pre-issue net worth. An unlisted company can make a public issue of equity shares or any security convertible into equity shares only through the book-building process, if it fails to comply with the above criteria and its proposed issue size exceeds five times its pre-issue net worth (sixty percent of the issue size shall be allotted to the Qualified Institutional Buyers (QIBs), failing which the full subscription monies will be refunded). A listed company is eligible to make a public issue, on fixed price basis or on book building basis, if the issue size does not exceed five times its pre-issue net worth. If the company, listed or unlisted, does not meet the above criteria, then the issue will have to be compulsorily made through book building route. In such a case, 60% of the issue size will have to be allotted to the 'Qualified Institutional Buyers'.
- Infrastructure companies are exempt from the requirement of eligibility norms if their project has been appraised by a public financial institution (PFI) or infrastructure development finance corporation (IDFC) or infrastructure leasing and financing services and not less than 5% of the project cost is financed by any of the institutions, jointly or severally, by way of loan and/or subscription to equity or a combination of both. Banks and rights issues of listed companies are also exempt from the eligibility norms.
- For public and rights issues of debt instruments irrespective of their maturities or conversion period, it is mandatory to obtain credit rating from a registered credit rating agency and to disclose the same in the offer document. If the credit rating is obtained from more than one credit rating agency, all the credit ratings, including the rejected ones, need to be disclosed. For a public and rights issue of debt securities with issue size greater than or equal to Rs. 100 crore, credit rating from two rating agencies is mandatory. All the credit ratings obtained during the preceding three years shall have to be disclosed in the offer document.

Thus the quality of the issue is demonstrated by track record/appraisal by approved financial institutions/credit rating/subscription by QIBs.

Pricing of Issues

The companies eligible to make public issue can freely price their equity shares or any security convertible into equity at a later date in cases of public/rights issues by listed companies and public issue by unlisted companies. In addition, eligible infrastructure companies can freely price their equity shares subject to compliance of disclosure norms of SEBI. The public and private sector banks can also freely price their shares subject to approval by RBI. A company may issue shares to applicants in the firm allotment category at higher price than the price at which securities are offered to public. A listed company making a composite issue of capital may issue securities at differential prices in its public and rights issue. Further, an eligible company is free to make public/rights issue in any denomination determined by it in accordance with sub-section (4) of section 13 of the Companies Act, 1956 and SEBI norms.

Contribution of Promoters and lock-in

The promoters' contribution in case of public issues by unlisted companies and promoters' shareholding in case of 'offers for sale' should not be less than 20% of the post issue capital. In case of public issues by listed companies, promoters should contribute to the extent of 20% of the proposed issue or should ensure post-issue holding to the extent of 20% of the post-issue capital. For composite issues, the promoters' contribution should either be 20% of the proposed public issue or 20% of the post-issue capital. The promoters should bring in the full amount of the promoters contribution including premium at least one day prior to the issue opening date. The requirement of promoters contribution is not applicable in case of (i) public issue of securities which has been listed on a stock exchange for at least 3 years and has a track record of dividend payment for at least 3 immediate preceding years, (ii) companies where no identifiable promoter or promoter group exists, and (iii) rights issues.

In case of any issue of capital to the public the minimum promoters contribution shall be locked in for a period of three years. The lock-in shall start from the date of allotment in the proposed public issue and the last date of the lock-in shall be reckoned as three years from the date of commencement of commercial production or the date of allotment in the public issue whichever is later. In case of pre-issue share capital of unlisted company, the entire pre-issue share capital, other than that locked in as promoters contribution, is locked for a period of one year from the date of commencement of commercial production or the date of allotment in the public issue, whichever is later.

For any issue of capital to the public, the minimum promoter's contribution is locked in for a period of 3 years. If the promoters contribution exceeds the required minimum contribution, such excess is locked in for a period of one year. Securities allotted in firm allotment basis are also locked in for a period of one year. The locked-in securities held by promoters may be pledged only with banks or FIs as collateral security for loans granted by such banks or FIs.

Issue Obligations

The lead merchant banker plays an important role in the pre-issue obligations of the company. He exercises due diligence and satisfies himself about all aspects of offering, veracity and adequacy of disclosures in the offer document. Each company issuing securities has to enter into a Memorandum of Understanding with the lead merchant banker, which specifies their mutual rights, liabilities and obligations relating to the issue. In case of under-subscription of an issue, the lead merchant banker responsible for underwriting arrangements has to invoke underwriting obligations and ensure that the underwriters pay the amount of devolvement. It should ensure the minimum number of collection centres. It should also ensure that the issuer company has entered into an agreement with all the depositories for dematerialization of securities. All the other formalities related to post-issue obligations like, allotment, refund and despatch of certificates are also taken care by the lead merchant banker. A compliance officer shall be appointed who will directly liaise between the Board and the issuer company with regard to compliance of various laws, rules, regulations and other directives issued by the Board. After a period of 21 days from the date the draft offer document was made public, the lead merchant banker shall file a statement with the Board giving a list of complaints received by it, a statement by it whether it is proposed to amend the draft offer document or not, and, highlight those amendments. The lead manager should also ensure that the issuer company has entered into agreements with all the depositories for dematerialization of securities. He should also ensure that an option has been given to the investors to receive allotment of securities in dematerialized form through any of the depositories.

Book Building

Book building is a process of offering securities in which bids at various prices from investors through syndicate members and based on bids, demand for the security is assessed and its price discovered. In case of normal public issue, the price is known in advance to investor and the demand is known at the close of the issue. In case of public issue through book building, demand can be known at the end of everyday but price is known at the close of issue.

An issuer company proposing to issue capital through book building has two options viz., 75% book building route and 100% book building route. In case of 100% book building route is adopted, not more than 60% of net offer to public can be allocated to QIBs, not less than 15% of the net offer to the public can be allocated to non-institutional investors applying for more than 1000 shares and not less than 25% of the net offer to public can be allocated to retail investors applying for upto 1000 shares. In case 75% of net public offer is made through book building, not more than 60% of the net offer can be allocated to QIBs and not less than 15% of the net offer can be allocated to non-institutional investors. The balance 25% of the net offer to public, offered at a price determined through book building, are available to retail individual investors who have either not participated in book building or have not received any allocation in the book built portion. Allotment to retail individual or non-institutional investors is made on the basis of proportional allotment system. Allotment to institutional investors is made on a discretionary basis. Allotment is done within 15 days of the closure of the issue failing which interest at the rate of 15% shall be paid to the investors. In case of under subscription in any category, the unsubscribed portions are allocated to the bidders in other categories. The book built portion, 100% or 75%, as the case may be, of the net offer to public, are compulsorily underwritten by the syndicate members or book runners.

Other requirements for book building include: issuer to provide indicative floor price and no ceiling price, bids to remain open for at least 5 days, only electronic bidding is permitted; bids are submitted through syndicate members; investors can bid at any price, retail investor have option to bid at cut off price, bidding demand is displayed at the end of every day; the lead manager analyses the demand generated and determines the issue price in consultation with the issuer, etc.

e-IPOs

A company proposing to issue capital to public through on-line system of the stock exchange has to comply with Section 55 to 68A of the Companies Act, 1956 and SEBI (DIP) Guidelines, 2000. The company is required to enter into an agreement with the stock exchange(s) which have the requisite system for on-line offer of securities. The agreement should cover rights, duties, responsibilities and obligations of the company and the stock exchanges inter-se, with provision for a dispute resolution mechanism between the company and the stock exchange. The issuer company appoints a Registrar to the Issue having electronic connectivity with the stock exchanges. The issuer company can apply for listing of its securities at any exchange through which it offers its securities to public through on-line system, apart from the requirement of listing on the regional stock exchange. The stock exchange appoints brokers for the purpose of accepting applications and placing orders with the company. The lead manager would co-ordinate all the activities amongst various intermediaries connected in the system.

In addition to the above sections, the DIP guidelines also provide details of the contents of the offer document and advertisement, other requirements for issues of securities, like those under Rule 19(2) (b) of SC(R) Rules, 1957. The guidelines also lay down detailed norms for issue of debt instruments, OTCEI issues, issue of capital by designated financial institutions and preferential/bonus issues.

Credit Rating

Credit rating is governed by the SEBI (Credit Rating Agencies) Regulations, 1999. The Regulations cover rating of securities only and not rating of fixed deposits, foreign exchange, country ratings, real estates etc. CRAs can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, foreign credit rating agencies recognised in the country of their incorporation, having at least five years experience in rating, or any company or a body corporate having continuous net worth of minimum Rs.100 crore for the previous five years. CRAs would be required to have a minimum net worth of Rs. 5 crore. No Chairman, Director or Employee of the promoters shall be Chairman, Director or Employee of CRA or its rating committee. A CRA can not rate (i) a security issued by its promoter, (ii) securities issued by any borrower, subsidiary, an associate promoter of CRA, if there are common Chairman, Directors and Employees between the CRA or its rating committee and these entities (iii) a security issued by its associate or subsidiary if the CRA or its rating committee has a Chairman, Director or Employee who is also a Chairman, Director or Employee of any such entity.

For all public and rights issues of debt securities of issue size greater than or equal to Rs. 100 crore, two ratings from different CRAs would be required. An obligation has been cast on the issuer to disclose in the offer documents all the ratings it has got during the previous 3 years for any of its listed securities, at the time of accessing market through a rated security. CRAs would have to carry out periodic reviews of the ratings given during the lifetime of the rated instrument.

Merchant Banking

The merchant banking activity in India is governed by SEBI (Merchant Bankers) Regulations, 1992. All merchant bankers have to be registered with SEBI. The person applying for certificate of registration as merchant banker has to be a body corporate other than a non-banking financial company, has necessary infrastructure, and has at least two persons in his employment with experience to conduct the business of the merchant banker. The applicant has to fulfill the capital adequacy requirements, with prescribed minimum net worth. The regulations specify the code of conduct to be followed by merchant bankers, responsibilities of lead managers, payments of fees and disclosures to SEBI. They are required to appoint a Compliance Officer, who monitors compliance requirements of the securities laws and is responsible for redressal of investor grievance.

Demat issues

As per SEBI mandate, all new IPOs are compulsorily traded in dematerialised form. The admission to a depository for dematerialisation of securities is a prerequisite for making a public or rights issue or an offer for sale. The investors would however, have the option of either subscribing to securities in physical form or dematerialised form. The Companies Act, 1956 requires that every public listed company making IPO of any security for Rs. 10 crore or more shall issue the same only in dematerialised form.

Private Placement

The private placement involves issue of securities, debt or equity, to a limited number of subscribers, such as banks, FIs, MFs and high net worth individuals. It is arranged through a merchant/investment banker, who acts as an agent of the issuer and brings together the issuer and the investor(s). On the presumption that these are allotted to a few sophisticated and experienced investors and the public at large don't have much stake in it, the securities offered in a private placement are exempt from the public disclosure regulations and registration requirements of the regulatory body. What distinguishes private placement from public issues, is while the latter invite application from as many subscribers, the subscriptions in the private placement are normally restricted to a limited number. In terms of the Companies Act, 1956, offer of securities to more than 50 persons is deemed to be public issue.

Market Outcome

Public Issues

The resource mobilisation from the primary market by way of IPOs and new issues by listed companies saw a decline during the year 2002-03 as compared to the previous year with only Rs. 40,703 million as against Rs. 75,431 million according to SEBI data (Table 2-2). The total number of scheme in 2002-03 were only 26 as compared to 35 in year 2001-02. Public issues (by listed companies and IPOs) 86% and 89% of total resources raised during 2001-02 and 2002-03 respectively, while the rest was by way of rights issues. The mobilization by rights issues was lower by approximately 59% compared to the previous year. Only twelve companies

Table 2-2: Resource Mobilisation from Public Issues

(Amount in Rs. mn.)

Issue	2001-02		2002-03	
	Number	Amount	Number	Amount
IPOs	7	12,018	6	10,387
Issues by Listed Companies	28	63,413	20	30,316
Public Issues	13	53,000	8	26,004
Rights Issues	15	10,413	12	4,312
Total	**35**	**75,431**	**26**	**40,703**

Source: SEBI.

used the right route which was the lowest number ever in the last decade. According to a press statement of the Prime database, the continuing fall in the number of companies tapping the rights route can be ascribed to the depressed secondary market prices of a vast majority of companies mainly due to poor fundamentals. Thus it is clearly seen that the companies opt for mobilizing money through the general public rather than the existing shareholders.

It is also observed from Table 2-2 that listed companies mobilised only Rs. 30,316 million through 20 issues during 2002-03, accounting for 74% of the resources, while there were 28 issues by listed companies for Rs. 63,413 million during 2001-02 with their share being 84%. A sharp fall of approximately 46% can be seen in the total resource mobilization from the public issues.

During 2002-03, there were 12 mega issues (Rs.100 crore and above) as against 15 such issues in the preceding year. The average size of an issue was Rs. 4,094 million in 2002-03 as against Rs. 3,380 million in 2001-02. There was no issue below Rs. 3 crore during 2002-03.

Most of the issues of capital were made by private sector companies, which made 18 issues and mobilised 46.6% of total resources during 2002-03 whereas the public sector companies made issues of only 8 in number but mobilized resources more than that of private sector companies with a contribution of 53.4% to the total resource mobilization (Table 2-3). The joint sector did not make any issue of capital for the past three years.

Table 2-3: Sector-wise Distribution of Resources Mobilised

(Amount in Rs. mn)

Sector	2001-02		2002-03	
	Number	Amount	Number	Amount
Private	30	66,015	18	18,973
Joint	0	–	0	–
Public	5	9,419	8	21,730
Total	**35**	**75,434**	**26**	**40,703**

Source: SEBI.

As per data available from Prime Database, the response to public issues has been worsening in the recent years. But as compared to 2001-02 where no issue was subscribed over ten times during (Table 2-4), 7% of the issues were subscribed over ten times during 2002-03. The most subscribed issue during 2002-03 was by Divi's Laboratories Ltd., which was over-subscribed 15.06 times. Only 28% of the public issues failed to elicit adequate response (1.5 times) during 2002-03, as compared to 80% of issues being subscribed less than 1.5 times during 2001-02.

Traditionally, debentures seem to dominate the public issues. But no clear trend is visible in the recent past. The share of debt in resource mobilisation through public issues increased

Table 2-4 Response to Public Issues

(% of issues)

Times Subscribed	2001-02	2002-03
< 1.5	80	28
1.5 - 3	15	50
3-10	5	14
> 10	0	7

Source: Prime Annual Report.

from 27.6% in 1995-96 to 84.7% in 1998-99, but declined sharply to 41.6% in 1999-00 (Table 2-5). The year 2000-01, however, witnessed reversal of trend and accounted for 47% of resource mobilization through public issues. It increased sharply to 83.12% during 2001-02. During the year 2002-03, it remained at the same level and mobilized about 82%.

Table 2-5 Resources Mobilised through Debt and Equity

Year	Percentage Share	
	Equity	Debt
1995-96	72.39	27.61
1996-97	55.99	44.01
1997-98	41.17	58.83
1998-99	15.34	84.66
1999-00	58.41	41.59
2000-01	52.79	47.21
2001-02	16.88	83.12
2002-03	18.00	82.00

Source: SEBI.

Banks and financial institutions (FIs) acquired approximately 84.6% of the total amount raised during 2002-03 as against 68.2% during the preceding year. IT sector companies showed a reverse trend this year as compared to last year mobilizing 5.6% as against 0.51% in the preceding year. The share of telecom sector in resource mobilisation declined to negligible value from 11.5% in 2001-02.

Table 2-6 Industry-wise Resource Mobilisation

Industry	Percentage Share	
	2001-02	2002-03
Banking/FIs	68.16	84.58
Cement & Construction	0.35	0.75
Chemical	2.48	0.38
Entertainment	0.00	0.00
Finance	0.43	0.72
Information Technology	0.51	5.58
Paper & Pulp	0.00	0.00
Plastic	0.00	5.34
Telecom	11.05	0.00
Textile	0.99	0.00
Others	16.03	2.65
Total	**100.00**	**100.00**

Source: SEBI.

Euro Issues

Indian companies also raise resources internationally through Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs) and American Depository Receipts (ADRs). GDRs are similar to Indian shares and are traded on overseas stock exchanges. In India, GDRs/ADRs are reckoned as part of foreign direct investment and hence need to conform to the existing FDI policy. Resource mobilisation by Indian corporates through Euro issues by way of FCCBs, GDRs and ADRs has been significant in the 1990s and witnessed increased activity during 2002-03. During 2002-03 the resource mobilisation through Euro issues was Rs. 34,264 million as against Rs. 23,415 million raised during 2001-02 (Table 2-1).

Performance of IPOs

A total of 8 IPOs were listed on NSE during 2002-03 belonging to different sectors viz., Media and Entertainment, Finance, Information Technology and Pharmaceuticals. The value of most of the IPOs appreciated quite substantially on the first day of listing/trading with a few exceptions. The maximum price appreciation was witnessed in Radaan Mediaworks India Limited (55.1%), a company belonging to the media and entertainment sector on its first day of trading/listing followed by Canara Bank (39.0%) and Divi's laboratories (25.9%) belonging to the banking sector and pharmaceuticals sector respectively. The maximum depreciation was witnessed by a company belonging to the Information Technology sector. Further, all the IPOs, except Radaan Mediaworks India Limited and Benchmark Mutual Fund-Nifty Junior Benchmark ETF had price appreciation by the year end as compared to their issue price.

The performance of IPOs listed on NSE during 2002- 03 is presented in Table 2-7.

Table 2-7: Performance of IPOs Listed on NSE During 2002-03

Sl. No.	Name of Company	Date of Listing	Issue Price (Rs.)	Close Price on first day of Trading (Rs.)	Close Price as at end-March, 2003 (Rs.)	Price Appreciation/ Depreciation on first day of Trading (%)	Price Appreciation/ Depreciation upto end-March 2003 (%)
1	Radaan Mediaworks India Limited	27-Feb-03	40	62.05	33.00	55.13	-46.82
2	Allahabad Bank	29-Nov-02	10	10.15	13.10	1.50	29.06
3	Canara Bank	23-Dec-02	35	48.65	71.40	39.00	46.76
4	Divi's Laboratories Limited	12-Mar-03	140	176.25	219.15	25.89	24.34
5	I-Flex Solutions Limited	28-Jun-02	530	501.05	898.85	-5.46	79.39
6	Punjab National Bank	24-Apr-02	31	37.4	101.75	20.65	172.06
7	Union Bank of India	24-Sep-02	16	16.35	25	2.19	52.91
8	Benchmark Mutual Fund-Nifty Junior Benchmark ETF*	6-Mar-03	142.78	137	125	-4.05	-8.76

Note

1. * Units of Mutual Fund
2. The date of fisrt day of trading for Radaan Mediaworks India Limited and Punjab National Bank was March 3, 2003 and April 26, 2002 respectvely.

Source: NSE

Book Building through On-line IPO System

Book building is basically a process used in IPO for efficient price discovery, wherein during the period for which the IPO is open, bids are collected from investors at various prices, which are above or equal to the floor price. The offer price is determined after the bid closing date. In it's strive to continuously improve Indian securities market, NSE offers its infrastructure for conducting online IPOs through book building. It helps to discover price as well as demand for a security to be issued through a process of bidding by investors. The advantages of this new system are: a) the investor parts with money only after allotment, b) it eliminates refunds except in case of direct applications and c) it reduces the time taken for issue process. The securities get listed within 15 days from the closure of the issue. Though the guidelines for book building were issued in 1995, it is being used for IPOs from 1999. Till June 2003, 19 issuers have used this route for making IPO issues. During 2002-03, 2 issuer have used the on-line IPO system of NSE to issue 71.66 lakh shares.

Debt Issues

Government and corporate sector accessed market through debt issues. They collectively raised a total of Rs. 2,350,956 million from primary market during 2002-03. About 77.4% of this was raised by Government, while the balance by the corporate sector through public issues and private placement as may be seen from Table 2-8.

Table 2-8: Resources Raised from Debt Markets

(Rs. mn.)

Issuer	2001-02	2002-03
Corporate	515,610	531,166
Public Issues	53,410	46,930
Private Placement*	462,200	484,236
Government	1,525,080	1,819,790
Total	**2,040,690**	**2,350,956**

* Only debt placements with a tenor and put / call option of 1 year or more.

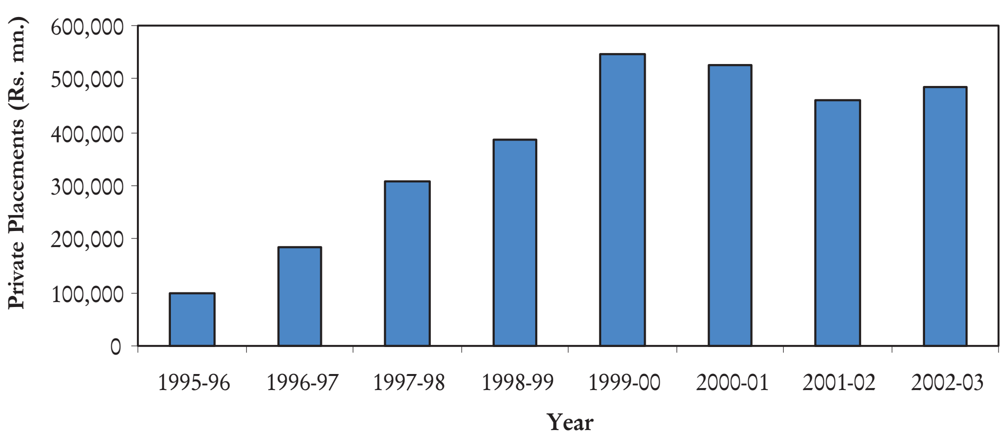
Source: Prime Database (for corporate debt) & RBI (for Government debt).

Private Placement of Debt

According to Prime Database estimates, a total of 171 issuers (institutional and corporates) raised Rs. 484,236 million through 485 privately placed issues in 2002-03. 246 issues out of 485 were made by the government sector who together mobilized 79% of the total amount. About Rs. 3,165,411 million have been raised through private placement of debt during the last six years. The growth of private placement market is presented in Chart 2-1.

Mostly, securities issued in the private placement market are debt securities. Though there are some instances of private placements of equity shares, there is no comprehensive data coverage of this. The two sources of information regarding private placement market in

Chart 2-1: Growth of Private Placement of Debt



India are Prime Database and RBI. The former data set, however, pertains exclusively to debt issues. RBI data, which is compiled from information gathered from arrangers, covers equity private placements also. RBI estimates find the share of equity in total private placements as very insignificant. Some idea about private placement of equity can be had from equity shares issued by NSE-listed companies on private placement basis. From the companies listed at NSE, a total of 22 companies came out with private placement issues mobilising around Rs. 606 million during 2002-03. The details of private placement issues by NSE-listed companies during 2002-03 are presented in Annexure 2-1. This indicates that equity private placement may not be that small an amount.

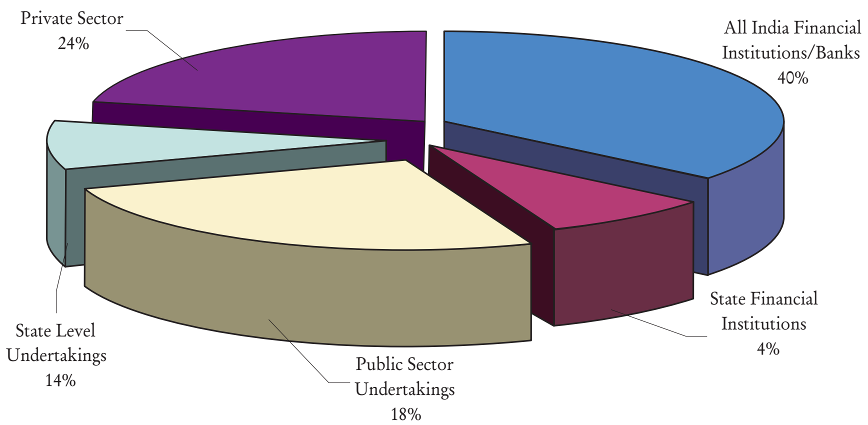
Public Sector units and FIs are most active in mobilising funds through private placement. They accounted for 78.8% of the total private placement market in debt instruments during 2002-03 as against 75.8% in 2001-02. All India Financial Institutions and Banks led the market with a 35.9% share followed by Public Sector Undertakings which accounted for 25.9% of the private placement of debt in the year 2002-03. The break up of funds raised by various categories of issuers is presented in Table 2-9 and Chart 2-2. The top '10' issuers accounted for 44.2% of total private placement during 2002-03.

Table 2-9: Issuer-wise Distribution of Private Placement of Debt

Issuer	Issue Amount (Rs. mn.)		% of Issue Amount	
	2001-02	2002-03	2001-02	2002-03
All India Financial Institutions/Banks	186,026	173,687	40.25	35.87
State Financial Institutions	17,087	38,665	3.70	7.98
Public Sector Undertakings	83,750	125,491	18.12	25.92
State Level Undertakings	63,338	43,894	13.70	9.06
Private Sector	111,998	102,498	24.23	21.17
Total	**462,199**	**484,236**	**100.00**	**100.00**

Source: Prime Database.

Chart 2-2: Issuer-wise Distribution of Private Placement of Debt, 2002-03



Sectoral distribution shows that the financial services sector continues to dominate the private placement market, raising 50% in 2002-03 followed by Power sector which accounted for 16% during the year. Sectoral distribution of the debt private placements is presented in Table 2-10.

Table 2-10: Sectoral Distribution of Resources Mobilised by Private Placement

(In per cent)

Sector	2001-02	2002-03
Financial	50	50
Power	16	16
Water Resources	4	3
Telecommunications	--	1
Others	30	30
Total	**100**	**100**

Source: Prime Database.

The maturity profile of issues in the private placement market ranged between 12 months and 264 months during 2002-03. The highest numbers of placements were for 60 months, 84 months and 120 months. A total of 142 offers provided for a put option while 142 provided for a call option.

Unlike public issues of bonds, it is not mandatory for corporates issuing bonds in the private placement market to obtain and disclose credit rating from an approved credit rating agency. Rating is, however, required for listing. Of the 485 debt private placement deals during 2002-03, 411 issues (85%) were rated; the rest (74) did not get rated.

Private placement accounted for 89.4% of total resources mobilised by the corporate sector from the primary market. The corresponding share of public issues was a meager 10.6% with share of public issues of equity and debt in primary market being 18% and 82%, respectively (Table 2-11).

Table 2-11: Resources Raised by Corporate Sector

(Amount in Rs. mn.)

Year	Public Equity Issues	Debt Issues			Total Resource Mobilisation (2+5)	Share (%) of Private placement in		Share (%) of Debt in Total Resource Mobilisation (5/6*100)
		Public Issues	Private Place-ments*	Total (3+4)		Total Debt (4/5*100)	Total Resource Mobilisation (4/6*100)	
1	2	3	4	5	6	7	8	9
1995-96	88,820	29,400	100,350	129,750	218,570	77.34	45.91	59.36
1996-97	46,710	69,770	183,910	253,680	300,390	72.50	61.22	84.45
1997-98	11,320	19,290	309,830	329,120	340,450	94.14	91.01	96.67
1998-99	5,040	74,070	387,480	461,550	466,580	83.95	83.05	98.92
1999-00	29,750	46,980	547,010	593,990	623,740	92.09	87.70	95.23
2000-01	24,790	41,390	524,335	565,725	590,520	92.68	88.79	95.80
2001-02	10,820	53,410	462,200	515,610	526,430	89.64	87.80	97.94
2002-03	10,390	46,930	484,236	531,166	541,556	91.16	89.42	98.08

*Data from 2000-01 onwards include only issues with a tenor and put/call option of 1year or more, while data for earlier years include all privately placed debt issues irrespective of tenor.

Source: Prime Database.

Corporate Debt

There is a preference for raising resources in the primary market through debt instruments and private placement of debt has emerged as the major route for raising resources. The corporate raised a total of Rs. 531,166 million through debt issues - Rs. 484,236 million through private placement and Rs. 46,930 million through public issues. The privately placed debt issues make up for the major part of the bond market, accounting for 91.2% of total debt issues in the primary market. The share of debt in total collection has been increasing consistently over the years and it stood at 98.1% in 2002-03. Resources mobilized by corporate sector through debt in the last few years is presented in Table 2-11.

Rating Summary

During 2002-03, 2,135 instruments for Rs. 5,239,130 million were rated by four credit rating agencies. As compared to this, 1,951 instruments for Rs. 4,759,760 million were rated during 2001-02 (Table 2-12 A). In terms of amount rated, 0.82% of ratings were upgraded, 6.84% were downgraded and 65.6% were reaffirmed. Of the total amount, 20.3% were new ratings. In terms of number of instruments rated, the ratings of 47 instruments (2.2% of total) were upgraded, while ratings of 182 instruments (8.5% of total) were downgraded. The credit ratings of maximum number of instruments were reaffirmed during the year.

Table 2-12 A: Rating Summary

(Amount in Rs. mn)

Status	2001-02		2002-03	
	Number	Amount	Number	Amount
Upgraded	19	24,370	47	42,890
Downgraded	255	1,012,000	182	358,500
Reaffirmed	1,046	2,382,300	1,234	3,437,470
Rating Watch	59	340,220	71	129,580
Withdrawn	146	38,740	165	206,230
Suspended	11	430	6	0
New Ratings	415	961,700	430	1,064,460
Total	**1,951**	**4,759,760**	**2,135**	**5,239,130**

Source: CMIE.

Of the total instruments rated during 2002-03, 1,997 instruments accounting for 93.5% of total were assigned investment grade, 64 instruments were rated as inadequately safe and 40 instruments were placed in risk prone and default category (Table 2-12 B).

Table 2-12 B: Rating Summary: Grades Assigned

Status	2001-02	2002-03
Investment	1,825	1,997
Inadequate Safety	58	64
Risk Prone	27	40
Default	36	32
Not Meaningful	5	2
Total	**1,951**	**2,135**

Source: CMIE.

Policy Debates

Private Placement

The rationale for investing in the private placement market lies in the convenience and flexibility to the issuers as well as investors. This market is preferred by small and mid-size firms, particularly new entrants who do not have track record of performance and hence are skeptical about generating adequate public response for their public issues. Even big-size firms may prefer this route if the general market environment is not conducive for floating public issues. This is also preferred by corporates wishing to issue securities with complex or non-standard features, as deals can be tailor-made to suit the requirements of both parties. Many companies may prefer private placements if they wish to raise funds quickly to take advantage of interest rate change in volatile market conditions. No regulatory compliance is another important reason why corporates prefer this route and avoid public issues.

The investors also have some advantages in subscribing to private placements. When there is not adequate supply of good public issues to match the amount of investible funds available, investors look for bonds at attractive rates in the private placement market. Further, the private placement market provides investors with securities with more or less fixed/predictable cash inflows, which help investor to match the expected stream of returns with the expected cash outflows. For many investors, matching asset/liability is an important goal, which can be fulfilled only in private placements, and not in public issues. The sophisticated investors, who possess the capability and expertise for assessing the risks associated with the issues, can earn higher returns by investing in these more risky investment avenues.

Given its apparent advantages, it is no surprise that private placement now provides a substantial part of corporate finance in India. What is missing is a comprehensive framework governing issue of securities in this segment. One obvious reason for the tremendous growth of private placement market could be an attempt by issuers to avoid regulatory compliance, which is mandatory for public issues. The absence of level playing field between the public issues and private placement market reflects regulatory arbitrage. It is quite plausible that public issues market is not gathering momentum as private placement market exists as an easier alternative.

The foremost concern in the private placement market is the quality of issues and extent of transparency in these deals. In the public issues, all the issues coming to the market are screened for their quality. In case of public issues, the investors rely on ratings and other information for evaluation of risk. The public issues market therefore works as a self-disciplining mechanism for the corporates willing to raise money from public. Such a screening mechanism is missing in case of private placements. This increases the risk associated with privately placed issues. As a prudential measure, all issues in the private placement market must disclose relevant information as in case of public issues. The transparency in transactions has to be ensured through the regulatory framework.

Many issues in the private placement market are made by public enterprises and often carry government guarantee as an element of security. Very little track is, however, kept of the end-use of funds. These issues can be a potential threat to the financial system because of likelihood of their turning non-performing assets in the absence of adequate attention being paid to the continued viability of projects. The default risk to investors could be a potential problem with private placement and may pose systemic risks if the subscribers to the issue happen to be large FIs.

In the absence of standardised disclosure requirements, credit rating is one way by which the investors can assess the risk before taking an investment decision. In the private placement market, however, it is not mandatory to obtain rating on debt instruments, even though some issues are accompanied by rating. The issuer is also not required to make fair disclosure of all the credit ratings obtained. It is essential to have a standard practice in this regard, irrespective of whether the issue is publicly issued or privately placed. In the absence of a regulatory norm in this regard, the subscribers should on their own insist on the debt issues being rated by a reliable credit rating agency as a pre-condition for investment. NSE insists on credit rating for listing of all privately placed debt issues by PSUs/statutory corporations, FIs, scheduled commercial banks, and private corporates.

The private placement issues are offered to mature and sophisticated institutional investors as opposed to general public. Among others, mutual funds are major subscribers in this segment in India. To a great extent, the money being invested by mutual funds in private placements is 'public money', collected from small or unsophisticated investors who are supposedly better off not exposed to the private placement market. It needs to be emphasised that to the extent mutual funds are investing 'public money' in the private placement market, these deals should be subject to same standards of disclosure as public issues.

As most of the privately placed issues are not traded in the secondary market, it is difficult to estimate the current value of such investments. Annexure 2-1 presents the issue price and the market price of private placement equity issues by NSE-listed companies as at end March 2003. The market value of most of these has come down drastically by the end of March 2003.

In order to ensure development of private placement market in a healthy manner, it is essential to lay down a clear policy framework for this segment. The regulatory fiat is necessary to put in place uniform practices.

Safety Net

In a move to protect the interests of the retail investors in the depressed market conditions where a majority of the scrip's of recent IPOs were quoting much below their offer prices, market participants have come out with novel ideas to build investor confidence. One such idea is to provide a safety net for all IPOs, that is, indemnify the investor for the losses that he may suffer on account of erosion in value of his holdings upto a period of say six months from the date of issue. What prompts such a suggestion is that the investors have lost heavily in recent years, as the prices of many new issues of securities opened substantially at a discount to issue price or crashed in a few days on stock exchanges. Such drastic decline in prices could happen because of aggressive pricing, inadequate disclosures, misuse of issue proceeds, etc. If any of the above is a reason, the investor should not suffer. Therefore, if an investor is allotted securities in a public issue, and the value of those securities declines below the issue price within six months, he would be indemnified to the extent of decline. If the liability on account of indemnity is borne by the issuer, it would prevent him from issuing/maintaining securities at unrealistic prices and consequently post issue prices would not be less than issue price. This would give investor confidence to subscribe to public issues as his loss is insured for at least six months.

Though the intention behind this suggestion is appreciated, a section of the participants feel that safety net is inconsistent with the nature of equity, as it supports prices at an artificial level by removing downside of equity. Further, it is illogical to provide such support, particularly if the price is market discovered such as through book building. The basic premise that the securities have lost value after the issue in the recent years may not be adequate justification for safety net, as securities across the board have lost their value during the same period. In about a year, the investors have lost about 50% of market capitalisation and by the logic of safety net, these investors would need to be compensated for this also. A variety of factors beyond the control of issuer affect the prices and the issuer can not be held responsible for all such factors. If he is held responsible for all such things, he would rather prefer not to access the market, which will be greater blow to primary market.

Annexure 2-1: Details of Private Placement Issues by NSE-listed Companies during 2002-03

Sl. No.	Name of Company	Number of Securities	Funds Raised (Rs. lakh)	Face Value (Rs.)	Issue Price (Rs.)	Close Price as end-March 2003 (Rs.)
1.	Alok Industries Limited	11,940,200	160.00	10	13.40	9.80
2.	Alok Industries Limited	2,000,000	20.00	10	10.00	9.80
3.	Color Chips Limited	1,000,000	10.00	10	10.00	5.00
4.	Ashapura Minechem Ltd	382,700	57.41	10	150.00	100.00
5.	Aurobindo Pharma Ltd	400,000	90.40	10	226.00	211.80
6.	Aurobindo Pharma Ltd	1,000,000	226.00	10	226.00	211.80
7.	Aurobindo Pharma Ltd	70,000	15.82	10	226.00	211.80
8.	Aurobindo Pharma Ltd	530,000	119.78	10	226.00	211.80
9.	Gujarat Ambuja Cement Ltd	8,000,000	1800.00	10	225.00	160.00
10.	Schenectady Herdillia Limited	12,000,000	240.00	10	20.00	21.00
11.	Ind-Swift Laboratories Ltd.	1,000,000	37.00	10	37.00	13.20
12.	Jain Irrigation Systems Limited	1,432,334	20.34	10	14.20	41.90
13.	Jain Irrigation Systems Limited	23,655,834	1830.02	10	77.36	41.90
14.	Natco Pharma Limited	4,270,500	72.60	10	17.00	27.55
15.	Nath Seeds Limited	4,000,000	40.00	10	10.00	5.50
16.	Nath Seeds Limited	2,000,000	104.50	10	52.25	5.50
17.	Pantaloon Retail (India) Ltd.	4,000,000	126.00	10	31.50	44.40
18.	Ruchi Infrastructure Ltd.	274,570	46.68	10	170.00	164.00
19.	Television Eighteen India Ltd.	700,000	61.60	10	88.00	50.80
20.	UTI Bank Ltd.	11,578,760	452.03	10	39.04	39.30
21.	UTI Bank Ltd.	1,980,940	77.34	10	39.04	39.30
22.	Uttam Galva Steels Limited	9,642,857	270.00	10	28.00	6.20
23.	Uttam Galva Steels Limited	4,160,500	41.61	10	10.00	6.20
24.	Vision Organics Limited	500,000	5.00	10	10.00	0.70
25.	Jain Studios Limited	584,882	12.36	10	211.29	11.00
26.	Jain Irrigation Systems Limited	12,676,055	18.00	10	14.20	41.90
27.	Infotech Enterprises Ltd	1,080,010	31.61	10	292.68	89.75
28.	Visesh Infosystems Ltd.	2,225,000	NIL	10	23.00	4.10
29.	Wellwin Industry Limited	7,000,000	NIL	10	29.00	7.40
	Preference shares					
1.	Great Eastern Shipping Co. Ltd.	55,000,000	55.00	10	10.00	–
2.	Great Eastern Shipping Co. Ltd.	20,000,000	20.00	10	10.00	–
			6,061			

Source: NSE.

Note: The Closing Date for Ashapura Minechem Limited and Ruchi Infrastructure Limited is taken as March 21, 2003 and September 2, 2002 respectively as these securities have not bene traded after that date.