

Primary Market

Introduction

The primary market plays an important role in the securities market by forming a link between the savings and investments. It is through this market that the borrower's viz., the Government and the corporates issue securities in which the investors deploy their savings. The primary market comprises, the public issues and the private placement market. A public issue consists of a company entering the market to raise funds from all types of investors; its debut is known as the initial public offer (IPO). In case of private placement, there are only a few select subscribers to the issue. The securities can be issued at a face value, or at a discount/premium; they may take a variety of forms such as equity, debt or some hybrid instrument. Apart from raising funds in domestic markets, resources are mobilized in international markets through the issuance of American Depositary Receipts (ADRs)/Global Depositary Receipts (GDRs) and External Commercial Borrowing (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 separately in Chapter 6.

After a long period of subdued activity, there were signs of revival in the public issues in 2003-04. This was due to the offers made by quality issuers evoking buoyant investors' interest (Table 2-1). In the private placement market, the SEBI, for the first time, imposed

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

	(Rs. mn.)	
Issues	2002-03	2003-04
Corporate Securities	752,411	695,030
Domestic Issues	718,147	664,050
Public Issues	48,667	71,900
Non-Govt. Public Companies	18,777	32,100
PSU Bonds	—	—
Govt. Companies	—	1,000
Banks & FIs	29,890	38,800
Private Placement	669,480	592,150
Euro Issues	34,264	30,980
Government Securities	1,819,790	1,981,570
Central Government	1,511,260	1,476,360
State Governments	308,530	505,210
Total	2,572,201	2,676,600

Source: RBI Annual Report.

stringent disclosure norms in September 2003. As a result, the resources mobilised by non-government entities fell from 88% in 2002-03 to 85% in 2003-04. The public issues mobilised



Rs. 71,900 million during this year. Further, the resources raised by Indian corporates from the international capital market through the issuance of FCCBs, GDRs and ADRs have declined marginally during 2003-04. With a view to integrate the Indian capital market, the foreign companies have been allowed to access the Indian capital market through Indian Depository Receipts (IDR) (discussed in detail in chapter 4).

Policy Developments

In order to refine the primary market design and boost the waning investors' confidence, various measures have been taken by the Government, RBI and SEBI. This section throws light on the policy measures initiated during the financial year 2003-04 and till June 2004.

I. DIP Guidelines

Given the SEBI's commitment to protect the investors' interests and to increase the transparency and efficiency of the primary market, stringent disclosure and eligibility norms have been issued. Further, various operational procedures for the issuers have been simplified to facilitate smooth mobilization of resources. In this regard, SEBI has set up various committees, which constantly review the guidelines; subsequently, SEBI has amended the SEBI (Disclosure and Investor Protection) Guidelines, 2000 as enumerated below:

Eligibility Norms

- An unlisted company may make an initial public offering (IPO) of equity shares or any other security, which may be converted into or exchanged with equity shares at a later date. Provided, it has a track record of profitability, and meets the conditions of net worth, net tangible assets etc. as specified in the guidelines.
- An unlisted company not complying with any of the above conditions may still make an IPO, if it meets the conditions: (a)(i) The issue is made through the book-building process, with at least 50% of the issue size being allotted to the Qualified Institutional Buyers (QIBs). Failing which the full subscription money have to be refunded OR (a)(ii) The "project" has at least 15% participation by Financial Institutions/Scheduled Commercial Banks, of which at least 10% comes from the appraiser(s). In addition, at least 10% of the issue size is to be allotted to QIBs, otherwise, the full subscription monies is to be refunded AND (b)(i) The minimum post-issue face value capital of the company has to be Rs. 10 crore OR (b)(ii) There should be a compulsory market-making for at least 2 years from the date of listing of the shares subject to certain conditions as specified in the guidelines.
- A listed company is eligible to make a public offer of equity shares or any other security which is convertible into equity shares. But, the aggregate issue size of the proposed issue along with all the previous issues made during the same financial year should not exceed 5 times its pre-issue net worth as per the audited balance sheet of the last financial year. If the name of the company has been changed in the last one year, then the revenue accounted for by the activity suggested by the new name should not be less than 50% of its total revenue in the preceding one full-year period.
- No company can make a public or rights issue of debt instruments (whether convertible or not), unless the following conditions are satisfied: (i) Credit rating of not less than investment grade is obtained from not less than two SEBI registered credit rating agencies.

- (ii) Company should not be in the list of willful defaulters of RBI. They should not have defaulted payment of interest or repayment of principal, if any, for a period of more than 6 months.
- An issuer company should not allot non-convertible debt instrument pursuant to a public issue, if the proposed allottees are less than fifty. In such a case, the company should forthwith refund the entire subscription amount received, a delay beyond 8 days attracts a penal charge of 15% per annum.

Promoters Contribution and Lock-in

- Prior to an IPO, the shares held by the persons other than the promoters, which are locked in may be transferred to any other person holding shares. This should be subjected to continuation of lock-in in the hands of transferees for the remaining period and compliance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- 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. Provided the lock-in of shares in the hands of transferees for the remaining period remains. They should also comply with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

Preferential Issues

- As in case of equity shares, the transfer of the locked in preference shares/instruments is subject to the same norms and comply with SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
- The lock-in period in respect of the shares issued on preferential basis pursuant to a scheme approved under Corporate Debt Restructuring framework should commence from the date of allotment. The lock-in period should continue for a period of one year. In case of partly paid up shares the lock-in period should commence from the date of allotment and continue for a period of one year from the date when shares become fully paid up.
- Unless the entire shareholding is held in dematerialized form, no listed company is permitted to make preferential issue of equity shares, warrants, Partly Convertible Debentures (PCDs), Fully Convertible Debentures (FCDs) or any other financial instruments convertible into or exchanged with equity shares at a later date.
- In case of the shares, warrants, PCDs, FCDs or any other financial instruments convertible into equity shares, which are issued on preferential basis, the entire pre-preferential allotment shareholding should be under lock-in. The lock-in period shall start from the relevant date up to a period of six months from the date of preferential allotment. In addition, the shareholders, who have sold their shares during the six months period prior to the relevant date, would not be eligible for allotment of shares on preferential basis.

Designated Stock Exchange

Following the withdrawal of the concept of a regional stock exchange, companies have to choose one stock exchanges as a designated stock exchange for the purpose of finalization of the basis of allotment.



Book Building Guidelines

- The issuer company should enter into an agreement with one or more stock exchange(s), which have the requisite system to offer on-line securities. The agreement should specify the rights, duties, responsibilities and obligations of the company and the stock exchange(s). The agreement should also provide for a dispute resolution mechanism between them.
- The freedom is given to the issuer company to list the securities on any other exchange and not necessarily on the exchange through which the company has offered the securities.
- The book runner(s)/syndicate members should appoint SEBI registered brokers to accept bids, applications and placing orders with the company. The appointed brokers should be financially capable of honouring their commitments arising out of defaults of their clients/investors, if any.
- The company should pay the broker/s a commission/fee for the services rendered. The brokers' are not allowed to levy a service fee on his clients/investors for his services.
- If the offer is through 100% book building process, then the following rules apply: (a) not less than 25% of the net offer should be made to retail individual investors; (b) not less than 25% of the net offer to non-institutional investors i.e. other than retail individual investors and QIBs; (c) not more than 50% of the net offer for QIBs.
- If 75% of the net offer is through book building process and 25% at the price determined through book building, then — (a) in the book built portion, not less than 25% and not more than 50% of the net offer should be available for allocation to non QIBs; (b) the balance 25%, offered at a price determined through book building, should be available only to retail individual investors. They will be either those who have not participated or have not received any allocation, in the book built portion. It is mandatory that 50% of the issue size is allotted to the QIBs.

Pricing of Issues

For an IPO by an unlisted company, if the issue price is Rs. 500 or more, the issuer company has the discretion to fix the face value below Rs. 10 per share subject to a lower limit of not less than Re. 1 per share. In case the issue price is below Rs. 500 per share, the face value ought to be Rs. 10 per share. The face value of shares should be disclosed in the advertisements and offer documents.

Post Issue Obligations

The allotment of shares should be on a proportionate basis within the specified categories, rounded off to the nearest integer. This will be subject to a minimum allotment being equal to the minimum application size as fixed and disclosed in the offer document.

Green Shoe Option

An issuer company making a public offer of equity shares can avail of the Green Shoe Option (GSO) for stabilising post listing of its shares, subject to certain provisions in the guidelines such as:

- A company desirous of availing the option should seek authorization in the general meeting for allotment of the additional shares to the 'stabilising agent' (SA) at the end of the stabilisation period.

- The company should appoint one of the merchant bankers or book runners, as the SA. They will be responsible for the price stabilisation process, if required. Prior to filing of offer document with SEBI, the SA should enter into an agreement with the issuer company clearly stating all the terms and conditions relating to this option including fees charged/expenses to be incurred.
- The SA should also enter into an agreement with the promoter(s) or pre-issue shareholders who will lend their shares. The agreement should specify the maximum number of shares that may be borrowed from the promoters or the shareholders which should not be in excess of 15% of the total issue size.
- The allocation of these shares should be on pro-rata basis to all the applicants. The stabilisation mechanism should be available for not more than 30 days from the date when trading is permitted on the exchange(s).
- The promoters and pre-issue shareholders, of both unlisted and listed company, holding more than 5% shares should lend the shares for the purpose of GSO.

Contents of Offer Document

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

- Some of the pertinent information have to be disclosed 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. However, the projected earnings should not be used as a justification for the issue price in the offer document. Further, the accounting ratios disclosed in the offer documents in support of the issue price should 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.

Guidelines for Issue of Advertisements

Every time the issue is advertised on television screen, the risk factors should not be scrolled on the screen, but the advertisement should advise the viewers to refer to the red herring prospectus or other offer document for details.

Miscellaneous

- The Board should provide exemptions 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.
- The minimum application value should be within the range of Rs. 5,000 to Rs. 7,000 and in multiples thereof.



- In a public issue by a listed company, the reservations can be made for the shareholders, who hold shares worth up to Rs. 50,000 on the record date, for allotment on proportionate basis as in case of allotment in public category.

II. Debenture Trustees Regulations, 2003

SEBI amended the SEBI (Debenture Trustees) Regulations, 2003 to include the following:

- (a) The capital adequacy should not be less than the networth of Rs. 1 crore, provided that a debenture trustee, who already is registered, should fulfill the networth requirements within two years from that date.
- (b) The net worth should be monitored by the debenture trustee on a continuous basis and inform SEBI for any shortfall in it. In such a case, they would not be entitled to undertake new assignments until they restore the net worth to the required level within a specified time.
- (c) Debenture trustee should not relinquish its assignments unless and until another debenture trustee is appointed in its place.
- (d) No debenture trustee should act as such for any issue of debentures in case it has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate. However, this requirement is not applicable in respect of debentures issued prior to the commencement of the Companies (Amendment) Act, 2000, where (i) recovery proceedings in respect of the assets charged against security has been initiated, or (ii) the body corporate has been referred to BIFR under the Sick Industrial Companies (Special Provisions) Act, 1985, prior to commencement of the SEBI (Debenture Trustees) (Amendment) Regulations, 2003.

III. Unlisted Public Companies (Preferential Allotment) Rules, 2003

The Unlisted Public Companies (Preferential Allotment) Rules, 2003, which came into force w.e.f. December 4, 2003, are applicable to all unlisted public companies issuing equity shares, FCDs, PCDs or any other financial instruments, which would be convertible or exchanged with equity shares. It states that no issue of shares on a preferential basis can be made by a company unless authorized by its articles of association and unless a special resolution is passed by the members in a General Meeting. The special resolution should be acted upon within a period of 12 months. In case, if warrants are issued on preferential basis with an option to apply for and get the shares allotted, then the issuing company should determine in advance the price of the resultant shares. In case of every issue of shares/warrants or any other financial instrument with a conversion option, the statutory auditor has to certify that the issue of securities has been done in accordance to the Rules.

Market Design

The primary market is governed by the provisions of the Companies Act, 1956, which deals with issues, listing and allotment of securities. Additionally the SEBI (Disclosure and Investor Protection) guidelines issued under the securities law prescribes a series of eligibility and disclosure norms to be complied by the issuer, promoter for accessing the market. However, in this section we discuss the market design as stipulated in the SEBI (DIP) guidelines.

DIP Guidelines, 2000

Disclosure and Investor Protection (DIP) Guidelines of SEBI, issued in June 1992, governs the issues of capital by Indian companies. SEBI has since then been issuing clarifications/ amendments to these guidelines from time to time, in order to streamline the public issue process. In January 2000, a comprehensive coverage of all DIP guidelines has been made available through a series of compendium 'SEBI (DIP) Guidelines, 2000'. The guidelines provide norms relating to the 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, among others. The guidelines apply to all public issues, offer for sale, and rights issues by listed and unlisted companies. This section attempts to highlight some of the important clauses in the guideline in a precise manner.

Eligibility Norms

Any company issuing securities has to satisfy the following conditions at the time of filing the draft offer document and the final offer document with SEBI and Registrar of Companies (ROCs)/ Designated Stock Exchange respectively.

- 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 ROCs. For a rights issue, filing of offer document is mandatory where the aggregate value of securities, including premium, if any, exceeds Rs. 50 lakh. An application for listing of those securities with stock exchange(s) is also to be made. Further, the company must enter into an agreement with the depository for dematerialisation of its securities and should give an option to subscribers/shareholders/ investors to receive the security certificates either in physical or in dematerialised form. 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 an IPO of equity shares or any other security, which may be converted into equity shares, only if it has a track record of profitability and required net worth and net tangible assets. Some of the conditions are specified hereunder: (i) it has net tangible assets of at least Rs. 3 crore in each of the preceding 3 full years, of which not more than 50% is held in monetary assets; (ii) it has a net worth of at least Rs. 1 crore in each of the preceding 3 full years; (iii) 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 immediately preceding 5 years; (iv) the aggregate of the proposed issue and all previous issues made in the same financial year in terms of 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 and (v) in case the company has changed its name within the last one year, at least 50% of the revenue for the preceding one full year is earned by the company from the activity suggested by the new name.
- Even if the above mentioned conditions are not satisfied, an unlisted company can still make an IPO on compliance of the guidelines as specified: (a)(i) issue should be made through the book building process with at least 50% of the issue size being allotted to the QIBs, if not, then the full subscription monies has to be refunded, OR (a)(ii) the project should have at least 15% participation by FIs/SCBs of which at least 10% should



come from the appraiser. In addition, at least 10% of the issue size should be allotted to QIBs, otherwise, the full subscription monies would be refunded; *AND* (b)(i) minimum post-issue face value capital of the company should be Rs. 10 crore, *OR* (b)(ii) there should be compulsory market making for at least 2 years from the date of listing subject to certain conditions as specified in the guidelines.

- For a listed company the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size should not exceed 5 times its pre-issue net worth. In case of the change in name of the issuer company within the last 1 year, the revenue accounted for by the activity suggested by the new name should not be less than 50% of its total revenue in the preceding one full year period.
- 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 Ltd. (ILFS) or a bank which was earlier a PFI and not less than 5% of the project cost is financed by any of the institutions referred above, jointly or individually, by way of loan and/or subscription to equity or a combination of both.
- No public issue or rights issue of debt instruments (whether convertible or not) can be made unless (a) it has a credit rating of not less than investment grade from not less than two credit rating agencies registered with SEBI, all the credit ratings, including the rejected ones, needs to be disclosed. All the credit ratings obtained during the 3 years preceding the public or rights issue of debt instrument for any listed security of the issuer company should also be disclosed in the offer document. (b) the company should not feature in the list of willful defaulters of RBI (c) company has not defaulted on payment of interest or repayment of principal of debentures issued to the public, if any for a period more than 6 months.

Pricing of Issues

The companies, including the eligible infrastructure companies, have the freedom to price their equity shares or any security convertible into equity in public or rights issues as the case may be. The banks, however, can price their shares subject to the approval by the RBI. A company (listed or unlisted) should issue shares to applicants in the firm allotment category at a different price from the one at which the net offer to the public is made. That is, at a higher price than at which the securities are offered to the 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 of equity shares in any denomination determined by it in accordance with sub-section (4) of section 13 of the Companies Act, 1956 and norms as specified by SEBI from time to time.

Contribution of Promoters and lock-in

The promoters' contribution in case of public issues by unlisted companies 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 share holding to the extent of 20% of the post-issue capital. For a composite issue, the promoters' contribution should either be 20% of the proposed public issue or 20% of the

post-issue capital. At least one day prior to the opening of the issue, the promoters should bring in the full amount of the promoters contribution including premium. Except for (i) public issue of securities which have been listed for at least 3 years and has a track record of dividend payment for at least 3 immediate preceding years, (ii) companies wherein no identifiable promoter or promoter group exists, and (iii) rights issues.

The minimum promoters' contribution should be locked in for a period of 3 years in case of all types of issues. However, if the promoters' contribution exceeds the required minimum, then the excess is locked in for a period of one year. The lock-in period starts from the date of allotment in the proposed public issue and the last date of the lock-in is to 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. 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

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. The lead merchant banker has to exercise due diligence and satisfies himself about all aspects of offering, veracity and adequacy of disclosures in the offer document. All the other formalities like, allotment, refund and despatch of certificates are also taken care by the lead merchant banker. The lead manager should also ensure that the issuer company has entered into agreements with all the depositories for dematerialization of securities. Also, the investors should be given an option to receive securities in dematerialized form through any of the depositories. In case of under-subscription of an issue, the lead merchant banker invokes underwriting obligations and ensures that the underwriters pay the amount devolved. The merchant banker has to appoint a compliance officer 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. Twenty-one days after the draft offer document has been made public, the lead merchant banker should file a statement with the SEBI giving a list of complaints received, a statement as to whether it is proposed to amend the draft offer document or not, and highlighting those amendments.

Subsequent to the post issue, the lead merchant banker should ensure that the post-issue monitoring reports are submitted irrespective of the level of subscription. Also, the merchant banker should be associated with allotment, refund and dispatch and also monitor the redressal of investor grievances arising therefrom. In a public-issue, the Managing Director of the Designated Stock Exchange along with the post issue Lead Merchant Banker and the Registrars to the Issue would be responsible for the finalization of allotment in a fair and proper manner. Allotment should be on proportionate basis within the specified categories rounded off to the nearest integer subject to the minimum allotment being equal to the minimum application size as fixed and disclosed by the issuer.



Book Building

Book building is a price discovery mechanism. Based on the bids received at various prices from the investors, demand is assessed and then the price of the securities is discovered.

The issuer proposing to issue capital through book building has two options, viz., 75% book building route and 100% book building route. In case of issue of securities through the first route, 75% of the net offer is made through book building process and 25% at the price determined by book building. In this case not more than 50% should be available for allocation to QIBs and not less than 25% to non-QIBs. The balance 25% should be made to the public at the price determined through book building. In case a company makes a issue of 100% of the net offer to public through 100% book building process, then not less than 25% should be available for allocation to retail individual investors, not less than 25% to non-institutional investors and not more than 50% for QIBs. Allotment to retail individual investors and non-institutional investors are made on the basis of the proportionate allotment system within 15 days of the closure of the issue; failing of which attracts a penal charge of 15% which is paid to the investors. In case of under subscription in any category, the unsubscribed portions can be allocated to the bidders in other categories.

Besides, book building also requires that: issuer should 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 investors 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 the on-line system of the stock exchanges has to enter into an agreement with the stock exchange(s). SEBI registered brokers should be appointed for the purpose of accepting applications and placing orders with the company. The issuer company should also appoint a Registrar to the Issue having electronic connectivity with the Exchanges. The issuer company can apply for listing of its securities on any Exchange other than the Exchange through which it has offered its securities. The lead manager co-ordinates all the activities amongst various intermediaries connected in the issue/system.

Credit Rating

Credit Rating Agencies (CRA) can be promoted by public financial institutions, scheduled commercial banks, foreign banks operating in India, and by any body corporate having continuous minimum net worth of Rs. 100 crore for the previous five years. Further, foreign credit rating agencies having at least five years experience in rating can also operate in the country. The SEBI (Credit Rating Agencies) Regulations, 1999 cover the rating of the securities listed and not fixed deposits, foreign exchange, country ratings and real estates. The applicant/promoters of a CRA should have professional competence, financial soundness and general reputation of fairness and integrity in business transaction; they should not be involved in any legal proceedings connected with the securities market. The CRAs are required to have a minimum net worth of Rs. 5 crore. 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 share a common Chairman, Director or Employee.

For debt securities with issue size greater than or equal to Rs. 100 crore, two ratings from different CRAs are required. The issuer should disclose in the offer documents all the ratings it has got during the previous 3 years for any of its listed securities, irrespective of whether it has been accepted or not. CRAs should continuously monitor the securities rated by them and disseminate any changes in its ratings, along with its history through websites, press releases etc.

Merchant Banking

The merchant banking activity in India is governed by SEBI (Merchant Bankers) Regulations, 1992. Consequently, all the merchant bankers have to be registered with SEBI. The details about them are presented in the table below:

Category of Merchant Banker	Permitted Activity	Net worth (Rs. Crore)
Category I	To carry on activity of the issue management, to act as adviser, consultant, manager, underwriter, portfolio manager	5.00
Category II	To act as adviser, consultant, co-manager, underwriter, portfolio manager	0.50
Category III	To act as underwriter, adviser, consultant to an issue	0.20
Category IV	To act only as adviser or consultant to an issue	Nil

Only a corporate body other than a non-banking financial company having necessary infrastructure, with at least two experienced persons employed can apply for registration as a merchant banker. The applicant has to fulfill the capital adequacy requirements, with prescribed minimum net worth. The regulations cover 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

SEBI has mandated that all new IPOs compulsorily should be traded in dematerialised form only. Further, the section 68B of the Companies Act, 1956, requires that every listed public company making IPO of any security for Rs. 10 crore or more should issue the same only in dematerialised form. The investors, however, would have the option of either subscribing to securities in physical or dematerialised form.

Private Placement

The private placement involves issue of securities, debt or equity, to selected 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). Since these securities are allotted to a few sophisticated and experienced investors,



the stringent public disclosure regulations and registration requirements are relaxed. The Companies Act, 1956, states that an offer of securities to more than 50 persons is deemed to be public issue.

Market Outcome

Public Issues

The year 2003-04 witnessed an upsurge in the primary market activity induced by a buoyant secondary market, sharp economic recovery, and political stability. The resource mobilisation by way of IPOs and new issues by listed companies leaped to Rs. 200,592 million in 2003-04 from Rs. 40,703 million in 2002-03. As compared with 52 total schemes in 2003-04, there were only 26 in the previous year (Table 2-2). The share of public issues in the total resources mobilized rose from 89% in 2002-03 to 92% in 2003-04. The mobilisation by rights issues also witnessed a manifold increase as compared to the previous year. According to a press statement of the Prime database (country's premier database on primary capital market), "the turnaround in the fortunes of the rights issues both by numbers and by amount has come about primarily because of the steady conditions in the secondary market and drying up of the ECB market. Companies offer shares on rights basis either to expand, diversify or simply to restructure their balance sheets."

Table 2-2: Resource Mobilisation from Public Issues

(Amount in Rs. mn.)

Issue	2002-03		2003-04	
	Number	Amount	Number	Amount
IPOs	6	10,387	17	32,766
Issues by Listed Companies	20	30,316	35	167,826
Public Issues	8	26,004	16	150,739
Rights Issues	12	4,312	19	17,087
Total	26	40,703	52	200,592

Source: SEBI.

A significant spurt can be seen in the total resource mobilisation from the public issues as shown in the Table 2-2. The listed companies mobilised Rs. 167,826 million through 35 issues during 2003-04, accounting for 84% of the resources, while in 2002-03, there were 20 issues by listed companies for Rs. 30,316 million.

During 2003-04, there were 22 mega issues (Rs. 1000 million and above) as against 12 such issues in the preceding year. The average size of an issue was Rs. 6,327 million in 2003-04 as against Rs. 4,094 million in 2002-03. There were only 2 issues below Rs. 30 million during 2003-04.

Most of the issues were made by private sector companies. Of the 52 issuers which tapped the market in 2003-04, 34 issues were by private sector issuers. They mobilised around 19.6% of the total resources raised. The public sector companies made 18 issues mobilising 80.4% to the total resources mobilised (Table 2-3). The joint sector has not been making any issue of capital for the past few years.

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

(Amount in Rs. mn)

Sector	2002-03		2003-04	
	Number	Amount	Number	Amount
Private	18	18,973	34	39,342
Joint	0	—	0	—
Public	8	21,730	18	161,250
Total	26	40,703	52	200,592

Source: SEBI.

For the past few years, debentures have been pre-dominant in the public issues. However, in 2003-04, there has been a reversal in this trend. The share of debt in resource mobilisation through public issues decreased from 82% in 2002-03 to mere 19.53% in 2003-04 (Table 2-4). While, the amount raised through equity issues have been the highest ever in the history so far of the Indian capital market.

Table 2-4 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
2003-04	80.47	19.53

Source: Prime Annual Report

The Banks and Financial Institutions (FIs) had assumed a dominant role in fund mobilisation. Their offers in 2001-02 and 2002-03 were 68.16% and 84.58% respectively, however, the year 2003-04 saw a significant fall to only 15.5% (Table 2-5). The chemical and the Information Technology (IT) industry collectively contributed approximately 10.2% in the resource mobilisation in 2003-04.

Table 2-5 Industry-wise Resource Mobilisation

Industry	Percentage Share	
	2002-03	2003-04
Banking/FIs	84.58	15.48
Cement & Construction	0.75	0.00
Chemical	0.38	7.34
Entertainment	0.00	0.76
Finance	0.72	0.35
Information Technology	5.58	2.82
Paper & Pulp	0.00	0.00
Plastic	5.34	0.00
Telecom	0.00	0.00
Textile	0.00	0.24
Others	2.65	73.00
Total	100.00	100.00

Source: SEBI.



Euro Issues

Indian companies raise resources from international markets through the issue of Foreign Currency Convertible Bonds (FCCBs), GDRs and ADRs. GDRs/ADRs are similar to Indian shares and are traded on overseas stock exchanges. In India, they are reckoned as part of foreign direct investment and hence, need to conform to the existing FDI policy. During 2003-04, the resources mobilised through Euro issues have been lower at Rs. 30,980 million as against Rs. 34,264 million raised during 2002-03 (Table 2-1).

Performance of IPOs

During 2003-04, eleven IPOs were listed on NSE of different sectors viz., Media and Entertainment, Finance, Information Technology, Pharmaceuticals and Manufacturing. The market price of almost all the IPOs appreciated quite substantially on the first day of listing/trading itself against their issue price. The price of Indraprastha Gas Limited rose by a whopping 148.75%, followed by TV Today Networks Limited (91.74%) and UCO Bank (63.33%). For few IPOs like Vardhaman Acrylics Limited, BAG Films Limited, Surya Pharmaceuticals Limited, Patni Computers Systems Limited and Petronet LNG Limited, the prices depreciated by end March 2004 (Table 2-6).

Table 2-6: Performance of IPOs Listed on NSE During April 01, 2003 to March 31, 2004

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, 2004 (Rs.)	Price Appreciation/Depreciation on first day of Trading (%)	Price Appreciation/Depreciation upto end-March, 2004 (%)
1.	Maruti Udyog Limited	9-Jul-03	125	164.3	497.45	31.44	297.96
2.	Vardhman Acrylics Limited	30-Sep-03	10	11.1	8.8	11.00	-12.00
3.	UCO Bank	9-Oct-03	12	196	22.22	63.33	85.17
4.	B.A.G. Films Limited	17-Oct-03	10	12.45	6.4	24.50	-36.00
5.	Jai Balaji Sponge Limited	9-Dec-03	10	13.1	15.95	31.00	59.50
6.	Indraprastha Gas Limited	26-Dec-03	48	1194	82.9	148.75	72.71
7.	TV Today Network Limited	16-Jan-04	95	182.15	133.45	91.74	40.47
8.	Surya Pharmaceutical Limited	21-Jan-04	45	52.25	37.75	16.11	-16.11
9.	Patni Computer Systems Limited	25-Feb-04	230	234.45	214.4	1.93	-6.78
10.	Four Soft Limited	12-Mar-04	25	26.05	23	4.20	-8.00
11.	Petronet LNG Limited	26-Mar-04	15	14.65	14.7	-2.33	-2.00

Source: NSE

As quoted in the RBI annual report 2003-04, “empirical evidence regarding the variation of IPO share prices for the period 2001-02 to 2003-04 indicates that share prices of about 75% IPOs improved upon listing. The variation was measured as the percentage change between the offer price and the market price of the scrip’s after six months. Stringent entry and disclosure norms introduced by the SEBI have had a significant impact on the quality of issues entering the market as well as their post-listing performance”.

Book Building through On-line IPO System

Book building is basically a process used in IPO for efficient price discovery. During the period when the offer 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 its endeavor to continuously improve the Indian securities market, NSE has offered an infrastructure for conducting online IPOs through book building. It helps to discover price as well as demand for the security to be issued through a process of bidding. The advantages are: a) the investor parts with money only after the allotment, b) it eliminates refunds except in case of direct applications and c) it reduces the time taken to process the issue. 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 also used for IPOs only from 1999. Till June 2004, 36 issuers have used this route for making IPO issues.

Disinvestment in PSUs in India¹

The terms 'disinvestment' and 'privatisation' are usually used interchangeably all over the world. In actuality though disinvestment represents sale of government share holding in public sector undertakings (PSUs), 'privatisation' is a more comprehensive concept and implies denationalisation including transfer of management and control to private entities. The disinvestment process in India has evolved over for more than a decade. The union budget of 1991-92 contained the first explicit statement on divestiture – the proposal to divest up to 20% of Government equity in select PSUs. The disinvestment commission was set up in 1996 and it recommended mainly a shift from public offerings to a strategic/trade sale with transfer of management in respect of a number of PSUs. The broad objective of disinvestment has been to reduce the fiscal deficit, and distribute the shares to a wider investor base. The disinvestment from fiscal 1991-92 is given in the table below:

(Amount in Rs. crore)

Year	No. of Company in which equity sold	Target receipt for the year	Actual receipts
1991-92	47	2,500	3,038
1992-93	35	2,500	1,913
1993-94	—	3,500	—
1994-95	13	4,000	4,843
1995-96	5	7,000	361
1996-97	1	5,000	380
1997-98	1	4,800	902
1998-99	5	5,000	5,371
1999-00	4	10,000	1,860
2000-01	4	10,000	1,871
2001-02	9	12,000	5,632
2002-03	6	12,000	3,348
2003-04	9	13,200	15,547

Source: Department of Disinvestment, Govt. of India (www.divest.nic.in)

Disinvestment through the capital market route is most preferred route these days as it has certain advantages over the strategic sale route e.g. (a) increases public ownership; (b) helps in better price discovery. This can be affirmed by the success of the companies which

¹ References: Ministry of Disinvestment website (www.divest.nic.in), Government of India and RBI Annual Report.



went for disinvestment through this route in 2003-04 viz., Maruti Udyog Limited, Indian Petrochemicals Corporation Limited, Gas Authority of India Limited, Oil and Natural Gas Corporation, CMC, IBP, ICI and DRDG.

Debt Issues

Government and corporate sector collectively raised a total of Rs. 2,509,089 million from primary market during 2003-04. About 78.97% has been raised by the Government, while the balance by the corporate sector through public issues and private placement (Table 2-7).

Table 2-7: Resources Raised from Debt Markets

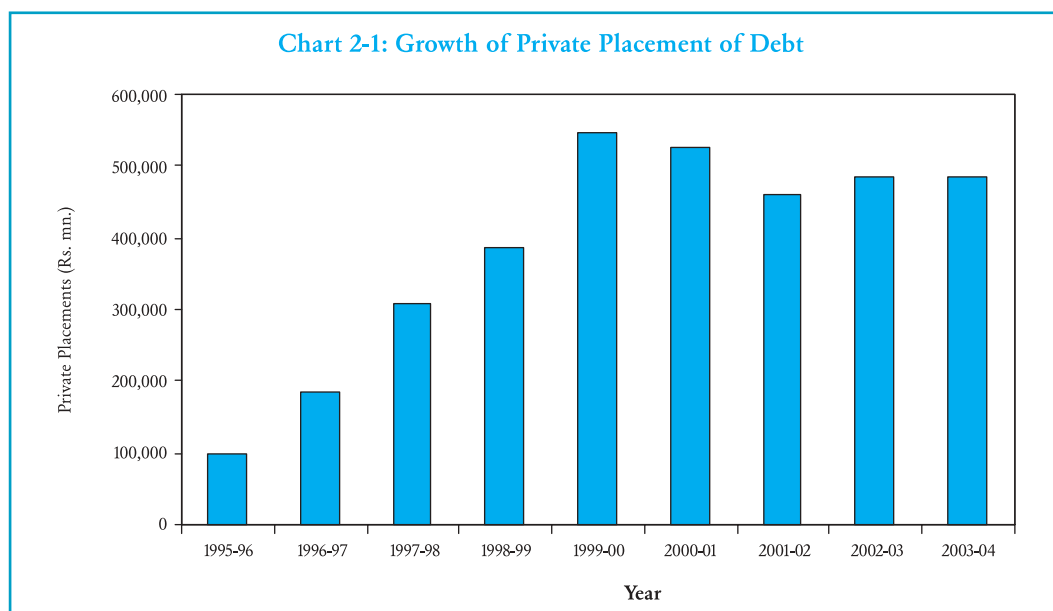
(Rs. mn.)		
Issuer	2002-03	2003-04
Corporate	531,166	527,519
Public Issues	46,930	43,240
Private Placement*	484,236	484,279
Government	1,819,790	1,981,570
Total	2,350,956	2,509,089

* 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 140 issuers (institutional and corporates) raised Rs. 484,279 million through 364 privately placed issues in 2003-04. 188 issues out of 364 were made by the public sector units, which together mobilised 87% of the total. The amount raised through the private placement of debt issues have been on an increasing trend over the past few years (Chart 2-1).



Mostly, debt securities were privately placed. Though, there were some instances of private placements of equity shares, there is no comprehensive data coverage of this. The two



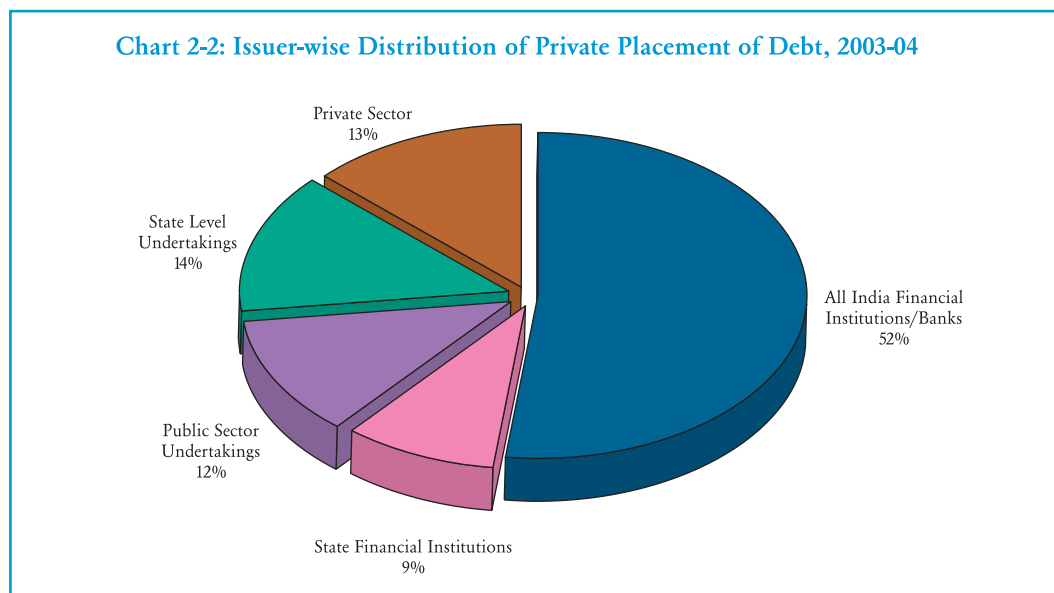
sources of information regarding private placement market in India are Prime Database and RBI. The former data set, however, pertains exclusively to debt issues. RBI data, which is compiled from information gathered from arrangers, covers equity private placements also. RBI estimates the share of equity in total private placements as rather insignificant. Some idea, however, can be derived from the equity shares issued by NSE-listed companies on private placement basis. A total of 20 companies listed on NSE privately placed equities, mobilising around Rs. 8,536 million during 2003-04 (Annexure 2-1).

Of the 364 debt private placements, 188 (52%) were from the government/banking sector that together mobilised 87% of the total amount mobilised. The All India Financial Institutions (AIFIs) & Banks continued to top the list with 52.3% (Rs. 253,088 million), followed by the State Level Undertakings with 13.5% share (Rs. 65,642 million) (Table 2-8 and Chart 2-2). The top '10' issuers accounted for 41.2% of total private placement during 2003-04.

Table 2-8: Issuer-wise Distribution of Private Placement of Debt

Issuer	Issue Amount (Rs. mn.)		% of Issue Amount	
	2002-03	2003-04	2002-03	2003-04
All India Financial Institutions/Banks	173,687	253,088	35.87	52.26
State Financial Institutions	38665.2	42,084	7.98	8.69
Public Sector Undertakings	125,491	58,809	25.92	12.14
State Level Undertakings	43,894	65,642	9.06	13.55
Private Sector	102,498	64,656	21.17	13.35
Total	484,236	484,279	100.00	100.00

Source: Prime Database.



Sectoral distribution shows that the financial sector continued to dominate the private placement market, raising 67% in 2003-04 followed by power sector, which accounted for 17% during the year (Table 2-9).



Table 2-9: Sectoral Distribution of Resources Mobilised by Private Placement

(In per cent)

Sector	2002-03	2003-04
Financial	50	67
Power	16	17
Water Resources	3	5
Telecommunications	1	1
Others	30	10
Total	100	100

Source: Prime Database.

The maturity profile of issues in the private placement market ranged between 12 months to 180 months during 2003-04. The largest number of placements was for 36 months and 120 months. A total of 65 offers had a put option, while 69 offers had 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 364 debt private placement deals during 2003-04, 328 issues (90%) went for rating and 36 did not get rated.

Private placement accounted for 68.6% of total resources mobilised by the corporate sector from the primary market (Table 2-10). The corresponding share of public issues was a meager 25.3%.

Table 2-10: Resources Raised by Corporate Sector

(Amount in Rs. mn.)

Year	Public Equity Issues	Debt Issues			Total Resource Mobilisation (2+5)	Share (%) of Private placement		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
2003-04	178,210	43,240	484,279	527,519	705,729	91.80	68.62	74.75

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

Source: Prime Database.

Corporate Debt

During 2003-04, the corporates raised a total of Rs. 527,519 million through debt issues, of which Rs. 484,279 million through private placement and Rs. 43,240 million through public issues. The privately placed debt issues make up a bulk of total debt issuances by accounting

for 91.8%. The share of debt in total collection had been increasing consistently over the years but witnessed a reversal in the trend and stood at 74.8% in 2003-04 (Table 2-10).

International Scenario

The much talked about 'Google IPO' has made a history in the international primary market by auctioning the securities to the retail investors and keeping investment bankers out of the whole process. Nevertheless, there were few such instances before, but they were unable to attract the investors community so significantly. Though, Google faced with criticism from all quarters, its IPO managed to pull through successful, this is expected to rewrite IPO rules in the US.

Most of the exchanges world-wide have indicated an increase in the capital raised in the year 2003 as compared with the previous year. Annexure 2-2 indicates region-wise mobilisation through IPO and capital increased by already listed companies.



Annexure 2-1: Details of Private Placement Issues by NSE-listed Companies during the period April 1, 2003 to March 31, 2004 and listed on the Capital Market segment of the Exchange

Sl. No.	Name of Company	Number of Securities	Funds Raised (Rs. lakh)	Face Value (Rs.)	Issue Price (Rs.)	Close Price as end-March 2004 (Rs.)
1.	Aurobindo Pharma Ltd.	1,050,000	2,373	10	226.00	374.6
2.	Usha Beltron Ltd.	5,264,727	1,737	5	33.00	37.80
3.	Usha Beltron Ltd.	5,345,455	1,764	5	33.00	37.80
4.	The Dhampur Sugar Mills Ltd.	10,000,000	1,000	10	10.00	24.50
5.	Padmalaya Telefilms Ltd.	2,000,000	2,844	10	142.20	56.05
6.	UTI Bank Ltd.	38,362,834	16,400	10	42.75	148.65
7.	Nuchem Ltd.	2,067,130	207	10	10.00	1.95
8.	Arvind Mills Ltd.	146,033	22	10	15.00	45.55
9.	Arvind Mills Ltd.	63,949	10	10	15.00	45.55
10.	Arvind Mills Ltd.	7,776,489	1,166	10	15.00	45.55
11.	Arvind Mills Ltd.	1,551,796	233	10	15.00	45.55
12.	Arvind Mills Ltd.	7,350,000	1,103	10	15.00	45.55
13.	Khandwala Securities Ltd.	120,000	26	10	22.00	9.05
14.	Strides Arcolab Ltd.	3,144,445	3,144	10	100.00	—
15.	Orchid Chemicals & Pharmaceuticals Ltd.	4,382,727	9,642	10	220.00	200.15
16.	Pantaloon Retail (India) Ltd.	865,000	433	10	50.00	288.65
17.	Jindal Vijayanagar Steel Ltd.**	279,034,907	27,903	10	10.00	8.20
18.	Shriram Transport Finance Co. Ltd.	6,243,000	749	10	12.00	—
19.	Strides Arcolab Ltd.	13,714,286	9,600	10	70.00	—
20.	Glenmark Pharmaceuticals Ltd.	8,185,570	5,000	2	61.08	143.70
		—	85,356	—	—	—

Source: NSE.

Note:

** indicates preference shares issued on preferential basis.

Annexure 2-2: Investment Flows Region-wise - New Capital Raised

(USD million)

Exchange	2003			2002		
	Capital Raised by New Shares	Capital Raised by Existing Shares	Total	Capital Raised by New Shares	Capital Raised by Existing Shares	Total
AMERICA						
Amex	23	3,589	3,612	20	1,949	1,969
Bermuda	NA	11	11	NA	16	16
Buenos Aires	0	349	349	0	173	173
Lima	0	397	397	0	290	290
Mexico	42	691	732	204	210	414
Nasdaq	6,365	NA	6,365	4,504	NA	4,504
NYSE	27,362	54,197	81,559	27,178	60,202	87,381
Santiago	2,573	0	2,573	0	152	152
Sao Paulo	0	1,955	1,955	130	5,114	5,244
TSX Group	8,465	9,439	17,904	5,808	8,646	14,454
Total Region			115,458			114,596
EUROPE - AFRICA - MIDDLE EAST						
Athens	69	2,113	2,182	87	1,736	1,824
Borsa Italiana	11,356	3,021	14,377	4,364	1,881	6,245
Budapest	66	1	67	0	3	3
Copenhagen	160	0	160	601	199	800
Deutsche Borse	0	0	0	203	0	203
Euronext	682	50,480	51,162	3,501	32,454	35,955
Helsinki	0	83	83	0	443	443
Irish	673	179	852	1,510	39	1,549
Istanbul	12	497	510	739	404	1,144
JSE South Africa	525	2,522	3,047	0	9,806	9,806
Ljubljana	41	0	41	116	0	116
London	7,591	22,624	30,216	8,093	26,310	34,403
Luxembourg	241	2,030	2,271	405	1,792	2,196
Malta	4	N.A.	4	98	NA	98
Oslo	834	52	886	685	27	712
Spanish Exchanges (BME)	12,439	5,371	17,809	16,001	5,389	21,390
Stockholm	NA	NA	NA	NA	NA	NA
Swiss Exchange	0	NA	0	7	NA	7
Tehran	242	675	917	38	505	543
Tel Aviv	32	703	735	15	1,184	1,199
Warsaw	0	379	379	2	139	141
Wiener Borse	1,701	1,078	2,779	1,085	51	1,137
Total Region			128,475			119,913

(Contd.)



Annexure 2-2: Investment Flows Region-wise - New Capital Raised (Contd.)

(USD million)

Exchange	2003			2002		
	Capital Raised by New Shares	Capital Raised by Existing Shares	Total	Capital Raised by New Shares	Capital Raised by Existing Shares	Total
<i>ASIA - PACIFIC</i>						
Australian	6,013	16,824	22,837	2,880	9,430	12,310
Colombo	11	102	112	1	10	11
HongKong	7,598	19,855	27,454	6,665	7,504	14,169
Jakarta	1,110	532	1,642	121	802	923
Korea	612	0	612	5,009	1,040	6,049
Kuala Lumpur	823	953	1,776	1,835	1,550	3,385
Mumbai	2,917	0	2,917	2,269	83	2,352
National Stock Echange of India	2,420	5,192	7,612	2,936	1,752	4,688
New Zealand	384	1,002	1,386	665	703	1,367
Osaka	39	4,934	4,973	28	2,242	2,269
Philipine	3	28	32	77	709	786
Shanghai	5,479	1,298	6,777	6,246	802	7,048
Shenzhen	616	438	1,054	1,207	307	1,514
Singapore	1,087	200	1,286	434	885	1,319
Taiwan	3,456	5,150	8,606	1,316	11,931	13,247
Thailand	NA	NA	NA	NA	NA	NA
Tokyo	NA	29,006	29,006	NA	15,749	15,749
Total Region			89,075			71,437

Source: WFE Annual Report & Statistics 2003.