CONCLUSION

Introduction

Following the initial phase in the Indian liberalisation process which involved the de­licensing of a large number of industries and trade liberalisation, subsequent changes focused on fiscal restructuring, banking sector reforms, and liberalisation of the capital market. Although India has been cautious to avoid full convertibility, the country substantially liberalised its domestic capital markets in 1992. This led to a rush of private corporate companies into the new issue market (NIM) and to a shift from a credit-based system to a capital market-based system of corporate financing. These changes were hastened by the decrease in budgetary support for public sector corporations from the central and state governments. As a result, the domestic capital market has come to play an important role in the financial system.

The 1990s, thus, seem to be a transition phase in the industrial financing activities in India, with the role of banks as intermediaries between savers and borrowers being reduced and the private corporate sector gaining direct access to the savers (household sector). The new issue market rose to prominence as a substitute for finance from banks and DFIs during the transition phase. This process of 'disintermediation' has significant implications for industrial development, through its impact on industrial financing.

Therefore, understanding the structure of this changing pattern of industrial financing becomes crucial. There are a number of questions that arise in this context. What is the dependence of Indian firms on external capital, and on the new issue market, in particular? Does an emerging equity market cause a structural transformation in the pattern of investments? If so, what is the nature of that transformation? Is the capital market boom of the nineties, brought about by this transformation of the roles of various channels of financing, sustainable? To answer these questions, this thesis undertook a detailed analysis of the structure of the NIM from 1989 to 1995.
Findings and Conclusions

In India, the capital market was highly regulated and was liberalised only since the beginning of the eighties. It was further opened up in 1992, with the introduction of various self regulatory legislation, and the creation of SEBI as an overall regulatory body for the capital market. It is seen from the results of the analysis of the NIM from 1951-1988 that NIM as a channel for private corporate investments in India has grown over the years. This growth can be periodised into the pre-intermediation phase, intermediation phase and pre-liberalisation phase. NIM showed a steady increase in the volume of capital raised from it in the pre-intermediation phase, followed by a near stagnation in the intermediation phase. Finally, the NIM experienced a boom in the pre-liberalisation phase, i.e.; in the 1980s, with debentures as the principal source of financing.

The NIM was found to be influenced by the various policies of the government. The cyclical pattern observed in the relative share of the NIM in investments can be attributed to various government policies relating to the mobilisation and channelling of savings, especially after the nationalisation of banks (in the intermediation phase). Other influential factors were regulations which forced closely held FERA companies to expand their equity base, and various promotional measures adopted in the 1980s to increase the role of the capital market.

The pattern of growth of the NIM varied across the three phases, in terms of both financial instruments and channels of marketing used by the private corporate firms. Equity and debentures were the two main instruments issued through the NIM. Equity issues showed a consistent trend in all three phases, clearly revealing its increasing role in the NIM. However, debenture issues were the most dominant instruments in the pre-intermediation and pre-liberalisation phases, though it registered a drop in share in the intermediation phase. This pattern in the choice of instruments in the NIM shows the influence of the prevailing economic conditions and policy changes during the various phases, on the financing decisions of firms. The greater reliance on equities relative to debentures during the intermediation phase points to the influence of the activities of banks and FIIs, which provided debt (equivalent to debentures) in the form of credit.

In terms of channels of issue, rights and public issues dominated this market through all the phases. The relationship between the channels, showed movement
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from a substitution between them in the pre-intermediation phase to complementarity in the second and third phases. The high share of rights issues in the pre-intermediation phase and later in the pre-liberalisation phase suggests that the choice of channels in the NIM was due to the role played by existing firms.

In the 1990s, with a general rise in expectations created by liberalisation and globalisation, there was a rapid growth in financing through the NIM after the abolition of the CCI, particularly, in its equity component. The evidence shows that in this period, while public sector investment decreased, that of the private sector increased. The increased investment activity of the private sector in the initial phase was supported by the growth of capital market support institutions and a 'scam-related' rise in the market prices of stocks. As is seen, during this phase, secondary market prices rose during 1989 to 1991. But, in the second phase during 1992 to 1995, the liberalisation of equity pricing led to a rise in equity investment in the primary market. This shift to stock market funds on the part of private corporate firms was due, to a very large extent, to a decrease in the credit availability to them caused by an increase in investments by banks in government securities. The macro analysis also revealed that there was an increase in the importance of NBFCs' deposits and investments in shares and debentures, in the composition of household savings. With household savings having a high share in total savings, this boosted the growth of NIM in the 1990s, both indirectly and directly. Thus, opening up of the capital market in the 1990s brought a large section of investors into the NIM and triggered an equity boom.

An analysis of changes in the structure of the NIM during 1989 to 1995 indicates that the main trend during this period was the large increase in public issues, involving both traditional instruments like equities and debentures, and a marginal, though increasing role for hybrid instruments. The results also point to a good performance in terms of response to these public issues. Evidence indicates that all firms which turned to the NIM were relatively successful in raising capital to meet their requirements. This suggests a process of disintermediation taking place in the economy, at the firm level.

The analysis of sources of financing of the sample firms corroborates the occurrence of a process of disintermediation in corporate financing. Sources like term loans from banks and financial institutions showed a remarkable drop in their shares in total finance of the sample firms, between the CCI and post-CCI periods. The large
increase in the combined share of equities, premium equities, debentures, etc. in total finance, clearly proves that the decrease in the share of term loans led to a greater reliance of the private corporate firms on stock market-based funds, and partly on internal resources. Premium sources also registered high growth during this period.

The size and age-wise analysis of sample firms shows that stock market-based funds were used largely by small/young and middle-aged/ medium firms, while the large/old firms relied on various other sources like term loans and public deposits etc. Thus, the nineties was a period of growth in equities, largely because of the growing participation of firms from the small/young and medium/middle aged categories.

Since a majority of the issues were in the form of public issues, an in-depth study of public issues was undertaken subsequently. It is observed that there was a growing popularity of public issues compared to rights issues, especially after 1993. Although public issues grew at a very high rate with a corresponding growth in equity issues, the small average size of issues reveals that a large part of this was due to the growth of small firms. While the instruments used (equity and premium) suggest the direct role played by liberalisation of capital markets since July 1992, it also points to the graduation of existing companies rather than an increase in new firms. As the increasing popularity of public issues and premium issues points towards this conclusion, this suggests a growing concentration of investments in existing companies.

The rise in pre-issue paid-up-capital, which was observed from the analysis on change in equitisation between the CCI and post-CCI periods, also suggests that there was an increased participation of existing firms, or an increase in the number of firms with higher contribution from promoters, in the NIM. This can happen in two ways: First, through an increase in inter-corporate investments in pursuit of objectives like financing of new projects via new companies by existing public limited companies, through channels like firm allotments; and second, an increase in the transformation of private companies (family owned businesses) into public limited companies.

The increase in the participation of existing firms in the 1990s, is also reflected in the increase in the number of firms issuing premium instruments. This was largely due to the liberalisation of price and premium fixation rules in 1992, which allowed firms in which the market had greater 'confidence', to come out with premium issues. These were mostly middle-aged existing firms which went in for public issues to
finance expansion and modernisation, and partly middle-aged financial companies while entered the market with working capital objectives.

The sample analysis unequivocally indicates a clear dominance of equity instruments in the 1990s, in terms of participation. Equities were the most frequently used instruments by a large section of firms. This is because, with liberalisation of pricing, there was direct issue of equities with and without premiums in the NIM, as the cost of equity capital decreased. Higher levels of capital (in amount) were raised through debentures during the 1990s, only due to some large debenture issues that were brought out mostly by public sector undertakings in financial services, petroleum, and iron and steel industries and by some large private companies. In fact, firms in most industries opted for equities and premium issues (broad-equity) in the early 1990s. Across industries, the service sector showed the highest usage of broad equity followed by manufacturing. The infrastructure sector was the only sector which showed a distinctly larger preference for debenture instruments.

The choice of instruments based on age and size-wise reveals a preference on the part of young and small firms for equity issues, and that of middle-aged / medium and old / large firms for debentures and premium issues. The prevalence of small and young firms in the use of equity issues gets exaggerated, due to a general aversion to equity issues by large companies and opening up of external markets like GDRs and ADRs, which kept the old and large companies away from the domestic primary market activities in terms of raising funds for the purpose of investment.

One general characteristic of the NIM which is evident from the analysis, is that small firms were the most dominant participants in the new issue market during the 1990s. Although there was a marginal drop in their share in total participation during the liberalised phase, they maintained their dominance. During the post-CCI period, there was also a high concentration of middle-aged and young firms. Old firms were found to be decreasing in share during the liberalised phase. This could be attributed to various liberalisation measures taken by the government during this phase related to industrial licensing, price control on equities, other capital market-related regulations regarding equity issues, taxation etc., which prompted the growth of equities, and encouraged new firms to exploit this new channel for raising funds. The results from the analysis of dependency of firms on the NIM by size and age of firms, also found
small and young firms to have become more dependent on stock market funds, than the larger and older firms.

It was also found that the dominance of small firms in the NIM was spread across all the industries with some sectoral differences. Overall, the dominant sector in the NIM during the 1990s was the manufacturing sector in India. However, though the manufacturing sector maintained its dominance during the liberalisation phase, its share dropped when compared with the pre-liberalisation phase. This was due to a growth in participation of the service sector, especially after 1992. The infrastructure sector had only a meagre share of about 0.6 per cent during both the phases. Relatively, small firms were found more in the service sector, followed by manufacturing and infrastructure sectors. Industrial sub-categories like financial services, chemicals and chemical products and food and food products dominated in the small size category.

Some of these were industries that were new to the NIM, like financial services and food and food products. Thus, the growth in the number of young firms participating in the NIM was concentrated among market participants from these two industries in addition to recreation and culture. A majority of these firms were less than one year old and had turned to the market for financing a new project. Middle-aged participants were concentrated in food products, chemical products and financial services industries.

However, the trend in the average size of investments revealed that there was a decline in the size of average investment of the small and medium firms in the liberalised phase, whereas large firms showed growth in average investments. While the latter was, again, largely due to some very large (especially, debenture) issues by public sector undertakings, the decline in the average size of investment especially among small firms, combined with the result that there was a large increase in the number of small firms, lead us to conclude that a large portion of the funds raised through the NIM in the 1990s got fragmented. Further, with the equity boom encouraging investments in small/young firms, whose representation in trading activities is low, investors could be faced with a lack of liquidity, leading to decreased confidence in the NIM in the future, which, in turn, could lead to lesser investment taking place in the NIM in subsequent periods.
The response analysis showed that during the post-CCI period, there was an increase in under-subscribed issues and a decrease in over-subscribed issues, when compared to the CCI period. This decrease in the share of firms with better response suggests that the increased participation of firms in the NIM led to a decrease in the average response rate. While there was over crowding of small firms in the NIM following liberalisation, small firms benefited (barring a few large firms which were highly over-subscribed) in terms of response generated in the NIM during the 1990s, as their requirement of capital is lower than that of large firms. Thus, the decrease in average response means that funds which would have potentially gone into large firms got scattered among a large number of small firms.

The analysis on mode of payment showed that firms that offered easy, instalment-based modes of payments received a very high response, which points to the presence of small individual investors in the NIM. With the data on post-issue performance of issuing firms suggesting low listing and trading activities in stock exchanges especially for new and small firms, the spread of surplus funds across small firms points to a situation wherein a large amount of investment from small investors got blocked. This trend only got aggravated with the regulation of the equitisation of over-subscribed issues. Thus, the small investors were left with very low returns on their investments in the NIM.

The location-wise analysis of NIM investments showed that firms from the western and southern regions (Gujarat, Maharashtra and Tamil Nadu) showed the largest shares of investment in chemical products, financial services and food products industries. But, it should be noted that, over the last three decades, the western and southern regions had proved to be better investment zones for private manufacturing firms. This clearly indicates that investments guided by market forces tend to flow to already developed and better off regions. In general, special incentives provided by lesser developed states did not give them any significant edge over others. Instead, the general perception of the investors about a state’s past performance in industrialisation, and their expectations regarding the stability of its future performance, have been the catalysts in propelling new investments through the NIM. Thus, in a stock market-based funding system, the objectives of balanced regional development would be overshadowed by the profit motive.
There was also high regional concentration of investments in industries like chemicals and chemical products and financial services. Certain other industries, like food products, were seen to be spread more evenly across the states. These trends in industrial concentration were influenced in part by: a) an increasing competition between the states for attracting investments; b) the liberalisation of the NIM from all regulatory controls of the CCI; c) deregulation of licensing; d) promotion of urban non-polluting high technology industries and the services sector; and e) the general trend of urbanisation in the country, which was also promoted by the investment activities of the government.

From the results of various analyses, it is established that the NIM, in the 1990s, promoted regional disparity by further concentrating industrial investments in India through: a) large concentration of firms in the southern and western regions; b) increasing investments in states like Maharashtra, Gujarat and Tamil Nadu, both in terms of size of investments and participation in numbers, leading to a dominance of these three states; and c) increasing popularity of tertiary sector industries like financial services and construction and consultancy and other services. The analysis of post-issue responses also indicated a high regional disparity with a bias towards issues floated by firms from the southern states.

The increase in regional concentration in industrial investments through NIM under liberalisation, could be attributed to an inherent weakness of a stock market-based system, which cannot monitor or regulate the flow of investments through it. The withdrawal of banks and DFIs from industrial funding aggravates this problem of unbalanced industrial development. What is required is an active role of banks and DFIs, along with NIM, in the financing of industrial growth.

The firms in the NIM had three major objectives for raising capital from the market. These were long term working capital (LTWC) which showed the highest growth compared to the CCI phase, followed by expansion and new projects. But, in terms of participation, the expansion objective had the highest share. In the category of financial needs of the firms, the working capital objective was the single dominant objective. Thus, overall, taking the productive and financial objectives together, the 1990s saw a decrease in the share of firms turning to the NIM with financing of new projects and modernisation objectives, and an increase in that of firms with expansion and working capital objectives. This was due to the role played by small firms which,
during the post-CCI period, showed less interest in the financing of new projects and a greater interest in financing of expansion and working capital.

The increase in importance of the working capital objective was clearly because of the growth of financial services firms (which were again dominated by small firms), which led to a movement of capital into small finance companies in India during the liberalisation phase. Nearly one fourth of these firms used equities to fund investments in the 1990s. This points to a growing asset mismatch problem in the use of funds, with growing investments in intangible assets. With growing investments in the services sector and high shares of investments in these sectors in working capital, there was an overall decrease in the share of productive investments (fixed assets).

The analysis of post-issue responses has shown that in terms of the amount raised there was a staggering surplus (six times) over and above the demand from the firms, which reflected the growing interest of investors in the NIM during 1989-95. However, the response analysis reveals that there was a concentration of these surplus funds into issues that were floated by firms in the services sector. Therefore, the service sector dominated the NIM in terms of increase in participation and also in response rates. Thus, liberalisation of the NIM led to a flow of capital from productive industries to service sector industries which concentrated on financing consumption and speculative activities. The better response rates among firms with working capital objectives, rather than those with expansion and new projects objectives, also point towards a movement of investments away from productive objectives.

The implications of these trends in the projected sources of financing and patterns of investment of firms participating in the NIM need to be noted. With long term funds flowing into short-term investments and capital moving away from productive to financial investments, primary market investments are turning more risky. This could lead to a substantial increase in volatility in the secondary market over a period of time. The shift seen at the national level into financial services and consultancy, construction and other services (tertiary sector) in the large cities, also points to the fact that a large part of the capital mobilised through the NIM has been channelled to finance hire purchase debt-based consumption.

During a boom following liberalisation, an increasing flow of capital to areas which are not directly productive could cause high volatility in market sentiments. For a capital starved economy like India, this trend can have long term implications like a)
bankruptcy, especially of small financial firms caused by short-term variations in production b) a fall in the stock market index caused largely by the speculative nature of trading activities, and, c) a slump in the NIM following financial firm bankruptcies, which could affect the future resource generation capacity of the market.

The post-issue balance sheet analysis carried out on nine per cent of the total sample to understand the effect of public issues on the performance of firms showed that the equitisation process helped many firms that had a high total debt-equity ratio during 1991 and 1993 to decrease their debt-equity ratios in the post-issue period. Further, it was found that in the post-issue period, the average annual growth of fixed investments was high in the case of these reputed manufacturing firms (in the small sample), suggesting an expansion of their production bases during the 1990s. Since a majority of firms had productive-need based objectives for their public issues, it could be said that the capital raised was indeed utilised for asset-building and capacity expansion. However, the fall in post-issue profits recorded by these firms shows that this production expansion did not translate into a rise in operating incomes for them. This was due to the recession in the manufacturing sector in the mid-1990s. However, during this period, most of the firms showed larger shares of non-operating income in gross profit, suggesting the use of share premium surplus for financing current assets.

The post-issue analysis on the effect of public issues on firms' performance also showed that current liabilities recorded a high growth rate across all the manufacturing industries (considered in the small sample). It could be concluded that for financing working capital requirements, these firms still depended on other sources of finance, mostly banks and financial institutions and not the stock market, which points towards the 'goodwill' factor which helped these firms in using banks and DFIs. Further, the growth rate of deferred liabilities was higher and this indicates that the role played by the stock market in financing firms' investments was complemented by banks and financial institutions, as there was a growth in both loans and other long-term debts. This could be because as most of the money raised by these firms from the NIM was through equities that are non-debt creating in nature, these firms could use the channel of deferred liabilities to finance more investments. This further confirms that firms that were better placed in terms of 'good will' used banks and financial institutions as a source of financing even in the equity boom period of the 1990s. Therefore, it appears that the growth of the NIM did not restrict the business of banks and financial
institutions and that the role played by the NIM was complementary to, rather than competitive with, that of the banking sector. Therefore, there should be recognition at the policy level that capital markets cannot be a substitute for banks' role, especially for a vast country like India, with large regional disparities in development and growth.

Another dimension of the trend in the supply of capital is that stemming from the increase in under-subscribed issues, mentioned above. This increases the obligations of underwriters (especially brokers and merchant bankers), who have to buy up the un-subscribed portion of these issues. The lack of liquidity created when there is no trading on such issues in the secondary market, constrains the underwriters' activities. Thus, in the long run, under-subscription of a large number of issues can lead to a weakening of various stock market-related institutions which are meant to promote and enable the growth of the NIM. Further, the high response exhibited by issues that had a large share of term loans, promoters' equities, or issues to existing shareholders, highlighted the role of insiders and also the better quality of such firms. The growth of under-subscribed issues during the post-CCI period, therefore, also points to a large rise in the number of firms which are of lower quality, which in turn suggests that the investments which were channelled to these firms were not used in the best manner.

All the above trends suggest that the overcrowding of public issues into NIM following liberalisation had several efficiency-related implications. This calls for a better management of the NIM in India through a regulation of public issues in terms of number of issues or amounts called for.

Policy Suggestions
The growth in the new issue market in the 1990s reflects the growth of public limited companies in India. The country, as of today, is second only to the United States of America, in terms of the number of companies listed in the stock exchanges. In the light of the findings and implications drawn from the study, the large increase in the number of small firms and the growing dispersion of shareholders across the country, there is an urgent need to device ways and means for better corporate governance. This is important to avoid conflicts in the public limited companies, for healthy functioning of this segment, in the larger interests of the economy. Corporate
governance forms one of the very important aspects of healthy functioning of the system.

**Macro-level Suggestions**

The following policy outlines may be suggested towards corporate governance of the issuing firms in NIM, at the macro level.

1. The growth of small financial services firms in the NIM should be regulated using stringent standards, to avoid the diversion of funds from productive investments.

2. A regular post-issue supervision of public issues should be carried out to monitor the flow of investments from the NIM. The deficient regions and industries thus identified, should be taken account of in the formulation of guidelines for credit allocation by the banking sector. The focus of such efforts from the banks should be the welfare needs of the regions.

3. Promotion of mutual funds as an alternative to direct funding activities in the NIM is necessary, as these institutions are better equipped (with analytical tools and insiders’ information) and have better bargaining power compared to individual investors scattered across the country.

4. There is an urgent need to construct a detailed centralised database on the investments through the NIM. This should be used to supervise the operations of the NIM, for better planning and evaluation of existing regulations and controls, and for monitoring post-issue performance.

5. Post-issue follow-up of firms making public issues through the NIM should be strengthened by making submission of regular reports compulsory for issuing companies, and actions should be taken against defaulters. Regulations in terms of listing and submission of annual reports, should be effectively implemented at the stock exchange-level.

6. Penalties and punishments should be effectively implemented against defaulters in the primary market.

**Firm-level Suggestions**

Annual General Body meetings are a yearly function where the company comes as a family, to make decisions on various important proposals for the year to come. In these meetings various decisions on dividend declaration, retained earning, management performance, and related issues are taken. These meetings are a very important channel through which the various interest groups sort out their differences.
in a democratic manner. In India, it has been noticed that these meetings have seen growing conflicts. One of the main groups which is affected in the whole process are the small investors.

There is an increasing tendency for a merger of interests between two or more large share holders (depending upon the dispersion of shares of companies). In many meetings of large corporate houses/companies who have a large number of small shareholders, it is found that the group of small investors are generally the most neglected. Therefore, AGMs have high functional value in terms of maintaining standards in corporate governance and preserving the confidence level of the small investors, who, in the future, would form the core of investors in public limited companies in India.

Therefore, strengthening and improving the function and conduct of Annual General Body Meetings in India is the need of the hour, to improve the confidence of large number of dispersed investors who have a large stake in this market. This can be done by replacing the present system of high cost AGMs by a cheaper alternative. One suggestion would be to have a centralised organisation to carry out this function using modern electronic mailing facilities and questionnaire methods. Such a move would benefit the small firms to conduct these AGMs at a cheaper cost, and would be an effective way to provide better representation to the growing number of small investors across the country in the management of the companies (refer Appendix XII for a detailed discussion).