Chapter: 3
Genesis and Development of IPO

3.1 The Beginning

It is well recognized that a developed capital market helps in generating more economic benefits including higher productivity, greater employment opportunities, and improved macroeconomic stability. The major driver of economic growth and development of a nation is its capital market. It impacts the economy by providing financial resources through its intermediation process for financing of long-term capital. Without an efficient vibrant capital market, it is widely believed, the economy may be starved of the required long-term capital fund for sustainable growth. The capital market acts as an intermediary in promoting growth with efficiency through the mobilization and incentivisation of savings and capital formation. Economic growth in a modern economy hinges on an efficient financial sector that pools not only domestic savings but also foreign capital for productive investments. It is needless to mention that without an effective financial system many productive projects may remain unexploited.

As evident, the development of capital markets has resulted two major sets of economic benefits. Firstly, it has helped to improve the allocation of capital as prices of security have responded immediately due to shift in demand and supply and made changes in the outlook for industries at large. Secondly, the security prices impound all these information in the price behaviour. The signal, created by such changes in security prices, encourages or discourages capital inflows into the industry or the company. Usually it is noticed that the higher prices encourage more investments in the sector or the company whereas the lower prices discourage the capital inflow into the industry or the company. It is also seen that the high returns attract additional capital quite easily, on the contrary, a drop in the return caused by decline in demand or due to the added capacity can affect the influx of capital flow adversely.

There is a broad consensus that performance of the stock market impacts the economy and this influence has magnified consistently over the years. This is understandable given that media coverage often blends the two as if they are the same. While the stock market may respond to economic indicators or news, it does
not always respond in the manner that makes sense. The economy and the stock market have a lot in common, however the stock market is not the economy and the economy is not the stock market. This makes perfect sense to some people and others find it confusing and misleading. The economy is a way of defining all we make, buy, sell and consume. The stock market is part of the economy, though its focus is very narrow, confined to securities that represent, for the most part, the largest and most robust companies. Many times the economy and the stock market move in the same direction, although not usually at the same pace and time. The economy is measured after-the-fact for e.g., unemployment is down during the last months or the growth in GDP is declining continuously etc. The stock market, on the other, responds instantly to changes in the economy and/or investor sentiment of the investors. It looks forward, rather than backward. For this reason, the stock market is always seen in touch with the economy. Stock investors bet on the future, so their sentiment may be out of sync with the economy that is always looking back. In that regard, the stock market is a leading indicator for the economy.

In this chapter we have focused on why and how have the stock market transformed from the domain of exclusive few to millions of people which has gradually encapsulated the economy and how new issue market has played a vital role in maturing the capital market.

3.2 Historical perspective of pre-reform era of Indian Capital Market

The history of the Indian capital market was traced way back to 1861 when the American civil war began. The opening up the Suez Canal during the 1860s led to a tremendous increase in exports to the United Kingdom and United States. Several companies were formed and many banks came to the fore to handle the complexity of finances relating to this trade during those period. The boom in cotton markets in Bombay was observed during post American civil war. In India, during this period the trading in shares of banks and cotton mills, existed in an unorganized forms, were mainly found at the two major business centre of that time – Bombay\(^1\) and Calcutta\(^2\). It was the principle of limited liability and transferability of shares that had greatly contributed to the growth of joint-stock companies since 1858 and provided the

\(^1\)Now Mumbai
\(^2\)Now Kolkata
necessary pedestal for the development of our modern security markets. It was in 1875 that an elementary association having 300 members was founded and in 1877, the first organized stock exchange in the country started its journey in Bombay under the name the ‘Native Shares and Stock Broker Association’, the oldest Stock Exchange in Asia. Several stock broking firms in Mumbai were family-run businesses and were named after the heads of the family. They include:

- D.S. Prabhudas & Company (now known as DSP, in joint venture with Merrill Lynch)
- Jamnadas Morarjee (Known as JM, in joint venture with Morgan Stanley)
- Champaklal Devidas (now called CIFCO finance) etc.

Though stock broking was practiced in Calcutta as early as in eighteenth century, East India Company used to transact loan securities. The member brokers had neither any code of conduct for their guidance, nor any permanent place for business. The centre of their activity was near a neem tree since the brokers had no shelter and businesses were carried on in the open place. The inconvenience of such trading, prompted brokers to organize themselves and in May 1908, an association was formed under the name of Calcutta Stock Exchange Association. The Swadeshi movement and the World War 1 subsequently gave another impetus in large-scale growth of joint-stock companies and security dealings. As a result many other stock exchanges were established in major business destinations like in Ahmedabad (1920), Madras\(^3\) (1920) etc. The great depression and international currency crisis during 1923-33 as well as the series of movements in India during the same period gave birth to a crisis where the business activities were greatly affected the security market in India. On 1\(^{st}\) September, 1939, Germany invaded Poland and consequently Great Britain and France declared war against Germany, which had a far reaching consequence in Indian stock market. This period of war witnessed a steady upward movement in the industrial share prices and an unprecedented spree of speculation with an increase in the number of stock exchanges.

The following figures amply clear the capital market scenario during the British raj in the pre-independence India. The figures show that the activity of joint

\(^3\) Now Chennai
stock companies surge appreciably from 1900 to 1911 and thereafter. The reason for this growth is largely attributed to the establishment of new trade centers and stock exchanges.

Table 3.1
Activity of Joint Stock Companies during the Pre-independence Period

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
<th>Total paid up capital (Rs. in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1882</td>
<td>505</td>
<td>15.7</td>
</tr>
<tr>
<td>1892</td>
<td>950</td>
<td>26.6</td>
</tr>
<tr>
<td>1900</td>
<td>1340</td>
<td>34.7</td>
</tr>
<tr>
<td>1913-14</td>
<td>2744</td>
<td>76.6</td>
</tr>
<tr>
<td>1919-20</td>
<td>3668</td>
<td>123.21</td>
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<tr>
<td>1924-25</td>
<td>5204</td>
<td>275.53</td>
</tr>
<tr>
<td>1931-32</td>
<td>7040</td>
<td>256.13</td>
</tr>
<tr>
<td>1938-39</td>
<td>11114</td>
<td>290.39</td>
</tr>
<tr>
<td>1943-44</td>
<td>13689</td>
<td>353.74</td>
</tr>
<tr>
<td>1944-45</td>
<td>14859</td>
<td>388.97</td>
</tr>
</tbody>
</table>

Source: Report on the Regulation of Stock Market in India- P.J. Thomas (1948)

Though the stock exchanges were in operation, there was no proper legislation for their regulation till the inception of Bombay Securities Contract Control Act enacted in the year 1925. The Capital Issues (Control) Act (CICA) came into effect in the year 1947 and subsequently the Securities Contracts (Regulation) Act, 1956 (SCRA) was enacted. The CICA had its origin during the pre independent period in 1943, the part of the objectives of the then British ruler was to channel resources to support the huge cost of war effort. After the independence, not much had changed in terms of legislation to run and control the stock exchanges and the independent India carried the British legacy till the reform process initiated in new economic policy in 1991. The planning process was initiated in India in 1951 with emphasis given to the formation of various categories of financial institutions. Earlier, to regulate the issue of share prices, the Controller of Capital Issues Act (CCI) was passed in 1947. Under the constitution, came into force on January 26, 1950, stock exchanges and forward markets came under the exclusive authority of the Central Government. The Government appointed the A. D. Gorwala Committee in 1951 to formulate legislation for the regulation of the stock exchanges and of contracts in securities. Following the
recommendations of the Committee, the SCRA was enacted in 1956 to provide for
direct and indirect control of virtually all aspects of securities market trading and the
day to day operation of stock exchanges and to prevent undesirable transactions in
securities. It had undergone several modifications since its enactment and given the
Central Government regulatory jurisdiction over (a) stock exchanges through a
process of recognition and continued supervision, (b) contracts in securities, and (c)
listing of securities on stock exchanges. As a condition of recognition, a stock
exchange has to comply with the conditions prescribed by Central Government.
Organized trading activity in securities is permitted on recognised stock exchanges.
Accordingly, the Controller of Capital Issues (CCI) was set up which was authorised
to grant approval for issue of securities and also to determine the amount, type and
most importantly the price of the issue which could easily be called as typically an
interventionist attitude by the government. The pre-liberalised economy in India
witnessed many such interventions by the government with explicit motive to control
and direct the flow of funds for favoured uses. The allocation of resources by
government, rather than by the market, contributed to shrinkage of the security market
which somehow made the Indian capital market inefficient at least allocationally.

3.3 Capital Market Reforms in India: An outline

The reform measures initiated and the subsequent evolution of the Indian
equity market since the early 1990s had been truly exemplary. The financial market
was virtually made open during mid-eighties with the removal of the difference in
banking system and the securities market ushering in unhindered flow of capital
across the globe. In India, the financial sector was thrown open to the global security
market to embrace the globalisation through various reform measures in order to
accommodate itself into the new world order. With the introduction of the new
economic policy initiated in 1991, the external finance assumed a new role with
increasing importance was given to long-term private source like bonds, FDIs, and
short-term portfolio capital.

The advent of globalization had changed the face and fate of the corporate
world dramatically. The consequence of the liberalization policy paved the way for
establishing a watchdog or guardian to monitor and regulate the capital market by
forming the SEBI (Securities and Exchange Board of India, the counterpart of SEC in
the US) which was originally set up in 1988 but the statutory power were entrusted in January 1992 to regulate the capital market. The mandate was to protect the interest of the cross-section of investors by ensuring compliance to rules and regulation in order to systematically develop the capital market. The most significant reform was initiated when the Capital Issues (Control) Act, 1947 was repealed on May 29, 1992 as part of the liberalization process initiated in India to allow the corporate to approach the market directly that paved the way for infusion of market principles in determining pricing of issues and allocation of resources among the competing users. The legal reforms began with the enactment of the Securities and Exchange Board of India Act, 1992, which established the Securities and Exchange Board of India (SEBI) with statutory responsibilities to (i) protect the interest of investors in securities especially the vulnerable small retail investors, (ii) promote the systematic development of the securities market, and (iii) regulate the securities market so that the menace of malpractices and scam could be handled properly and can easily be diagnosed before having any spiraling effect. This was followed by repeal of the Capital Issues (Control) Act, 1947 in 1992 which paved way for market determined allocation of resources. This was followed by the enactment of the Securities Laws (Amendment) Act in 1995, which extended SEBI’s jurisdiction over the corporate entities in respect to issuance of capital and transfer of securities, in addition to all intermediaries and persons associated with securities market. It also empowered SEBI to appoint adjudicating officers to address wide range of violations and impose monetary penalties, if needed.

The regulation also provided for establishment of Securities Appellate Tribunals (SATs) to hear appeals against the orders of the adjudicating officers. This was subsequently followed by the Depositories Act in 1996 to provide for the establishment of depositories in securities with the objective of ensuring free transferability of securities with speed and accuracy. It made securities of public

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4 Securities Appellate Tribunals (SATs) - The central Government shall, by notification, establish one or more Appellate Tribunals to be known as Securities Appellate Tribunal to exercise the jurisdiction, powers and authority conferred on such Tribunal by or under this Act. Recently, the Supreme Court has come down heavily on the SAT for restraining market regulator SEBI from taking coercive action against Sahara India.
limited companies freely transferable subject to certain exceptions, dematerialised the securities in the depository mode and provided for maintenance of ownership records in a book entry form. The setting up of a depository and the introduction of ‘scripless’ trading and settlement had improved the efficiency of the markets, thereby eliminated the various problems associated with the dealing in physical certificates. The Government of India promulgated the ‘Depositories Ordinance’ in September 1995, thus paving the way for setting up of the depositories in the country. The National Securities Depository Ltd.(NSDL) was registered on 7th June, 1996. The Depositories Related Laws (Amendment) Act, 1997 amended various legislations to facilitate dematerialization of securities. The Securities Laws (Amendment) Act, 1999 was enacted to provide a legal framework for trading of derivatives of securities. The Securities Laws (Second Amendment) Act, 1999 was enacted to empower SAT to deal with appeals against orders of SEBI under the Depositories Act and the SEBI Act, and against refusal of stock exchanges to list securities under the Securities Contracts (Regulations) Act, 1956. The SEBI (Amendment) Act, 2002 also enhanced the power of SEBI substantially in respect of inspection, investigation and enforcement.

The National Stock Exchange (NSE) of India was set up by the government on the recommendation of Pherwani Committee in 1991. It was promoted by leading financial institutions led by IDBI and was incorporated in November 1992 as a tax-paying company to provide a modern, fully automated screen-based trading system with national reach. In April 1993, it was recognised as a stock exchange under the Securities Contracts (Regulation) Act, 1956. NSE commenced operations in the wholesale debt market (WDM) segment in June 1994. The capital market (equities) segment of the NSE commenced its operations in November 1994, while operations in the derivatives segment were commenced in June 2000.

The exchange has since been endeavouring continuously in bringing transparency, speed and efficiency, safety and market integrity. The market provide state-of-the-art information technology to introduce several innovations in products and services viz. demutualisation of stock exchange governance, screen based trading, compression of settlement cycles, dematerialisation and electronic transfer of
securities, securities lending and borrowing, professionalisation of trading members etc.

Pricing of issue throughout the globe has drawn tremendous attention to all participants, both national and international, involved in new issue market. There are at least three distinct mechanisms adopted by the issuing firm: fixed price offer, book-building and auctions. Many countries in the world follow any one of these methods or combination of these pricing mechanisms. An issuer company is allowed to freely price the issue and disclose it in the offer document. Book-building method of pricing IPOs came into operation as a consequence of the recommendations by the Malegam committee, set up by the SEBI in 1995. Initially the method of book-building was not so popular but with repeated amendments and revisions it becomes common to the investors interested in IPOs.

Book building is basically a price and demand discovery mechanism by which the demand feedback of the investors applied for the IPO can be ascertained. It is an interactive process, a marked shift from the earlier process involving offer and acceptance under fixed price regime. Here the investors themselves have to determine the price which they are willing to pay and what is acceptable to the issuer company. It helps to determine a realistically fair price as it is determined on the basis of bids made by the investors. The cost of issue is generally reduced significantly and there are less chances of IPO underpricing.

The existence of deep and broad capital market is absolutely crucial and critical in spurring the growth of any country. An essential imperative for India has been to develop its capital market to provide alternative sources of funding for companies and in doing so, achieve more effective mobilization of investors' savings. Capital market also provides a valuable source of external finance. For a considerable period of time, the Indian capital market was considered too small to warrant much attention globally. However, this view has changed rapidly as vast amounts of international investment have started pouring into the Indian equity markets since the last decade. The Indian market is no longer viewed as a static universe but as one of most constantly evolving markets providing attractive opportunities to the global investing community.
3.4 The Indian Equity Market in Recent Times

The Indian capital market today is regarded as one of the promising markets in the world as far as daily return (average) and daily volatility (average) is concerned. It presents a vastly different picture from what it was a decade ago. In India, the investments in equity are driven by irrational emotions of greed and fear. The market swings to the tune of innumerable events across the globe. Whether the Nikkei falls or rise or the Nasdaq or Dow Jones behaves bearish or bullish makes a great impact on the Indian securities market. And possibly there are numerous such instances where market falls drastically. And the factors cannot be measured objectively since it involves from Pakistan to Palestine from foreign policy to fringe benefit tax, all have a bearing on the market.

The markets acquired breadth and size in the late 1980s and early 1990s due to initial momentum provided by the multinationals (MNCs) dilution followed by a spate of public issue and disinvestments by the public sector undertakings (PSUs). Till recently, the Indian markets lacked the depth in terms of players and asset classes. As a result, the retail stakeholders perform as venture capitalist, speculator and investor –all in one. The major fall out of the reforms is the increasing disintermediation in the capital markets. There has been a marked shift from staid and conventional sources of funding to bold initiatives in the capital market. The corporate sector directly accesses the market rather than rely excessively on institutional and bank borrowings.

The Indian financial market, lying dormant and at its infancy phase till the 1990’s, have witnessed a great resilience during the last two decade which is in sharp contrast to the policy failures in other realms of the economy. The factors that are often claimed to have contributed to the great success of the equity market can be due to the following reasons:

a) Establishment of SEBI and its supremacy over the capital market vis-à-vis other entity like NSE, BSE and NSDL, etc. within a clearly demarcated legal framework.

b) A massive infrastructural uplifting in the functioning of exchanges in India coupled with free entry into financial intermediation has helped the Indian
capital market to place on a strong foundation. Introduction of demat account through depository mechanism and the implementation of electronic computerized system of trading transform the Indian capital market from scream based to screen based one.

c) Presence of large heterogeneous mass of traders, including both domestic and foreign investors and large number of households, this was not the scenario India has witnessed earlier.

d) Introduction of new efficient price discovery mechanism is often cited by many as one of the major landmarks for the common men to look for capital market. The book-building method of pricing has contributed to the growth of pricing mechanism as it is transparent than the previous fixed issue pricing.

e) Last but not the least the less intervention by the government.

From the above discussion, it is amply clear that overall improvement in Indian macroeconomic fundamentals, improvements in financial technology and increased institutional automation led to the growth of the equity market. Automation has indeed led to the growth of trading activity and consequently lowered the transaction costs significantly. The access to the stock market has also been aided by the increase in the number of trading terminals. In this regard, it is to be remembered that the foreign institutional investors’ (FIIs) and mutual funds have also contributed to the burgeoning trading volumes in Indian stock market. The surge in FIIs since 2003 has been unprecedented and it is not surprising that the activity in the equity market tends to correlate with the inflows of foreign capital.

Now, let’s explore some of the indicators which may throw some lights on the gradual development in activities of the Indian stock market. One commonly used indicator to capture the stock market development is the ratio of stock market capitalization (the value of listed shares on the stock exchanges) to GDP. The ratio has risen from 24.5 in 1998 to 54.2 in 2011. This can be seen from the following picture (figure 2.1) which depicts how does market capitalization play a dominant role in the composition of GDP in Indian economy. The upward trend line observed in the picture tells the story. This ratio is generally used to determine whether a stock market is overvalued or undervalued, and it is calculated by dividing the stock market capitalization with the gross domestic product and multiplied by 100. The result thus
exhibits the percent of GDP represented by stock market capitalization. A result of 100% or above signifies that the market is overvalued. This was observed in 2007, when the ratio was as high as 146.9 percent.

**Figure 3.1**

![Market Capitalisation to GDP Ratio in India](image_url)

Source: World Bank

If we look at the relationship between GDP growth and stock market there is a wide-spread perception in the mind of investors that the stock market and the economy are closely associated with each other. Actually in the stock market, the securities of listed companies are traded and the stock price may be defined as the discounted value of the future cash flow and it simply reflects the market expectations about the future earnings of the company.

Since we have restricted our study solely and exclusively to the NSE listed equities, a brief introduction about the NSE and its achievement has already been highlighted in the earlier section. Here, we will explore the indexes that NSE maintains. The NSE maintains as many as ten major indices and 18 other sectoral indices. Among them the most prominent index such as Nifty 50, Nifty 500, Nifty 100, Nifty Junior etc. are worth mentioning. In our entire study we prefer to use Nifty 500 instead of popular Nifty 50, simply because the former index is much broader than the later and to measure the performance we need to compare the respective companies with respect to certain broad based index. Since most of our sampled
companies are mid-cap or small cap barring few large-cap companies, it would be prudent to employ Nifty 500 as our benchmark index in the study. It should be noted that in Nifty 50, only 50 stocks are picked with certain parameters and the movement in the index is construed as the movement of the market which, it is assumed, is too simplistic assumption.

However, in the following picture we have plotted the two popular indexes as maintained by NSE (Nifty 50 and Nifty 500) and we have also observed their movement. From the following depiction it can easily be inferred that both the indexes move in more or less the same direction over the period, while the Nifty 50 always outperform the Nifty 500, as is expected.

**Figure 3.2**

![Movement of NSE Indexes](image)

The capital market, despite remarkable growth in terms of market capitalization, remains superficial in terms of inclusiveness. Despite increase in number of listed companies both in BSE and NSE, only shares of 30 companies are incorporated in BSE sensex and 50 in case of Nifty. Moreover not all the equities are
available for trading. A major chunk of shares is held by the promoters and FIIs leaving not much room for the small retail investors to penetrate the market.

3.5 Initial Public Offering (IPO) - An Overview

The lack of depth in our domestic capital markets was one of the major impediments that have hindered India’s drive to increase the level and efficient usage of domestic savings and investments to achieve economic growth. During the last decade, it is observed that a large number of companies have raised huge sums of money as capital by issuing equity shares through IPO (Initial Public Offering) process.

An IPO is the first public offer of securities by a company since its inception, with the expectation that gradually a liquid market would develop. Although an IPO can be issued both for debt or equity, we prefer to focus only on equity issue for our study. An IPO is referred to the selling of securities to the public through the primary market. It is regarded as the largest source of funds for the companies with long or indefinite maturity period. It is seen that most of the companies have started out to raise the corpus of equity funds from a close group of people. Therefore, the company’s need for additional capital can only be met by issuing shares to a large number of diversified investors through the IPO process.

The term ‘IPO’ slipped into everyday speech during the tech bull market of the late 1990s in U.S. and other world stock exchanges. Back then, it was murmured you could not go a day without hearing about a dozen new dot-com millionaires in Silicon Valley cashing in on their latest IPOs. These phenomena had spawned the term “siliconaire”, which described the dot-com entrepreneurs in their 20’s and 30’s who suddenly found themselves living large due to IPOs from their internet companies.

In India, the corporate entities can be classified into two: private and public. A privately held company has fewer shareholders and its owners do not have to disclose much information about the company. Anybody can go out and incorporate a company by just putting in some money, filing the right legal documents and following the reporting rules to the respective jurisdiction. It is usually not possible to buy shares of a private company. Public companies, on the other hand, have to sell at
least a portion of themselves to the public and trade in a stock exchange. This is why doing an IPO is also referred to as “Going Public.”

The IPO market in India has experienced many upheavals in the past and has invited the attention of the media for scams in the allotment of shares. The charges leveled are that few individuals have got a large disproportionate number of shares allotted in some companies going through IPOs by duping various companies under fictitious names. The role of the banks as well as Depository Participants (DPs) has therefore come under scanner. The scam in the allotment of IPO shares has raised an important question- what do make the investors rush towards IPOs? As now it is clear that there is a significant difference in the prices at which the IPOs are offered to the investors and the price at which the IPOs behave immediately after listing in the first day. So it is obvious that the investors will always be eager to get them allotted in an IPO at a somehow lower offer price and then sell them on the first day of listing at higher prices, and thereby reaping substantial gain in the process.

Studying the IPOs in the Indian markets is important for another reason. India has become probably the first country in the world to introduce a rating mechanism for its IPOs prior to the listing. Though rating of debt instrument is fairly common and can be seen in various financial markets, rating the equity instrument is indeed a unique feature. Apparently, the aim of this exercise is to make the investors appraise about the fundamentals of the firms where they are going to invest their money in. However, it is to be remembered that the rating ascribed by the agency at the behest of the market regulator, SEBI, is not the complete assurance about the ‘quality or valuation’ of the issue. It can only convey message about the fundamentals of the firm, however, it does not recommend the investors to buy the issue. The rating agencies simply evaluate the firm and give rating on the basis of the disclosures made in the prospectus. So, in effect, the rating agencies simply act as a catalyst to investors by simplifying and reducing the voluminous documents to understand and decide later. As such, this can be construed as the signal to a retail investor about the credibility of the IPO firm in general. However, the efficacy of this rating is yet to be tested empirically.
3.5.1 The rationale behind public offering

The obvious reason for going public is to raise lot of cash which are obviously critical for the sustenance and future health of the companies. Being publicly traded, the system also opens many financial doors to the issuing companies. An IPO can be used both as a financing strategy and exit strategy. In case of a financing strategy, the main purpose of the IPO is to raise funds for the company. An IPO, on the other, can be used as an exit strategy when the existing investors off load their equity holdings to the public. However, following are the basic reasons for IPO issue as identified and opined by many experts in this field.

1. It is observed that the reason for going public is for capital expenditure programme like expansion, diversification, modernization etc. and for various reasons of organic growth / development within the given industry such as acquisition of brand, etc.

2. As long as there is market demand, a public company can always issue more shares. Thus, mergers and acquisitions are easier to do because stock can be issued as part of the deal.

3. Trading in the open market means liquidity. This makes it possible to implement things like employee stock ownership plans (ESOP), which eventually helps to attract and retain top talent, given the higher attrition rate, the companies are now desperate to retain the talent pool for future sustainability.

4. It often acts as an important vehicle to exit from the market; the companies can offload their holdings through disinvestment process as practised by some PSUs.

5. Many companies going public simply to meet the increased / growing needs of working capital.

6. Because of the increased scrutiny, public companies usually get better rates when they issue debt and once listed and going through the rigorous requirements of listing, also acts as an incentive to maintain managerial effectiveness.
7. Being registered in major stock exchanges carries considerable status and prestige to the stakeholders. However, the decision is not an easy one as it results in dilution of ownership stake and diffusion of corporate control.

However, following are the major factors identified as advantages of public offering:-

a) It provides liquidity to existing shareholders.
b) Enables better valuation of the company.
c) Increasing the visibility and reputation of the company, which is essential in today's business environment. It is easy to spot the listed company thanks to the bandwagon effect of various agencies tracking the capital market.
d) It gives the company ample choices to utilise the funds. For example, the company can offer its share as purchase consideration or as an exchange for the shares of another company.
e) Facilitates future funding by means of subsequent public offerings.

3.5.2 Challenges of going public

1. Loss of Control

In case 50% or more shares are concentrated to few outsiders, the original owner or the present incumbent could lose the control of the company. Dilution of ownership stake makes the company potentially vulnerable for future takeovers.

2. Loss of Privacy

The registration and subsequent reporting requires disclosure of many facets of companies’ business operations and finances that may have never been published before. Some sensitive areas of disclosure that will be available to competitors, customers and employees are compensation given to managers and directors including stock option plan and cash compensation, the shareholding of the directors, managers etc. And the extensive financial reporting such as sales, net profit, major customers, cash flow etc.
3. **Excessive Compliance**

The company going public has to comply strictly with certain rules and regulations as framed by SEBI. The company needs to make consistent disclosures practices and follow increased regulatory monitoring which is indeed a very strenuous job. All the financial activities and viability will be under strict vigilance which may not necessarily be liked by the company management.

4. **Burden of Expenditure**

It involves substantial expenses ranging 4 percent to 15 percent of the size of the issue. These costs generally includes under-writing fees (4 to 7%), fees related to legal and accounting advices and printing costs. In addition to this there are other costs such as exchange listing fees and compliance related cost and it also give rise to recurring expenses after the process of going public is over. At the same time, it also consumes lot of precious time for the management.

5. **Pressure for performance**

As a stakeholder, the shareholders expect steady growth in sales, profit, market share, and product innovation. Thus, the management is always under pressure to balance short-term demand and long-term goals achievements.

6. Last but not the least the management must ensure that the benefits must outweigh the cost of going public.

Apart from the above general discussions made on the basics of IPO, going public is not an easy decision on the part of the management. The following queries must be looked into besides the mandatory question as to why should we go public. The PwC in a report titled “Roadmap for an IPO – A guide to going public” (2010) list such questions which the management must satisfactorily answer before going public.

   a) Why should we go public?
   
   b) Is going public right for your company?
c) Does your company have attractive track record? [This includes some of the important factors such as an attractive product or service line and a vast untapped market for the product or services, an experienced dedicated team of management, an upward trend of historical financial results, a well thought out focused business plan etc.]

d) Whether your company have reached the level at which the prospect for maintaining a strong sales and earnings growth trend in the future are reasonably good?

e) Whether your products or services are highly visible and of interest to the investing public?

f) Is your company prepared to furnish timely the financial statements with the SEBI? [Since the public companies required to furnish financial statements on a quarterly and annual basis with the SEBI, with a prescribed data requirement in order to adhere to rigorous SEBI guidelines for compliance.]

g) Is leadership capable and committed?

h) Where should you list your stock or which exchange is to be selected? [Each of the stock market has specific entry requirements. A company intending to go public must choose the market that is right for its stock.]

i) Is the market right or whether the timing of the issue is appropriate? [The demand for IPOs can vary dramatically depending on the overall market strength and host of other extraneous factors that makes the proper timing of going public key in achieving the best possible results.]

j) Whether the benefits achieve could outweigh the costs? [The management must ensure that the benefits must outweigh the costs of going public otherwise the whole process and its objectives become a futile exercise.]

There is no denying the fact that macroeconomic environment governs the capital market of a country. In this chapter the historical perspective of the pre-reforms era and the phases of development of Indian capital market are discussed. The fallout of the reform measure during post-1991 in the functioning of stock exchanges in India, establishment of the National stock exchange (NSE) as the first stock exchange credited with transforming the trading mechanism from a scream-based to
screen-based one. The supremacy of SEBI in implementing the rules and guidelines and making the Indian capital market transparent which eventually attracted large number of foreign players in Indian capital market, and finally origin and development of IPO are discussed in this chapter.