Chapter 6

Conclusion
6.1 General Observations

Growth of private business enterprises in an economy gets constrained if sufficient external finance is not easily available\(^1\) and firms are left with no other option but to depend primarily on internal finance to fund their growth. In a perfectly competitive framework, the costs and ease of availability of internal finance do not differ from those of external finance. However, in the presence of various market imperfections (like transaction costs, taxes, information asymmetry), external finance becomes costlier than internal finance. In extreme situations, external finance may simply not be available to certain categories of firms. If firms have to depend on internal finance only (or to a significant extent) for financing their growth, they would not be able to adopt all the profitable investment opportunities as they would be limited by their own past growth financed by own resources.

Thus, availability of external finance is crucial not only for an individual firm, but for the whole economy as well. External finance can be raised from broadly two sources: financial institutions (like banks) and financial markets (public/private market for debt or equity).

Economists have observed that financial institutions or banks are relatively more important than financial markets as a source of external finance in certain economies, while the reverse is true in other economies (of course, some countries witnessing a roughly equal importance of the two sources). Economists have argued and debated over centuries about the merits and demerits of bank-based and market-based financial systems\(^2\).

\(^1\) Here ease of availability of external finance is emphasized, and not its cost (i.e., interest rate or cost of equity) as the cost of external finance, especially when it is high, is a macro problem so long as the ease of availability is ensured; when ease of availability of external finance is absent, it is a structural problem irrespective of the level of its cost.

\(^2\) Schumpeter (1911), Fisher (1933).
In more recent past, especially after the works of Keynes, Robinson (“where enterprise leads, finance follows”), Gurley, Shaw and McKinnon, a more fundamental question occupied the center-place of the debate: whether development of financial system is at all important for economic growth. After the work of McKinnon (1973), debate on this line lost steam. The debate has been rekindled in recent years (especially since the early 1990s) due to a seminal contribution in empirical economics by King and Levine (1993). Although a number of scholars have been arguing on the theoretical plane about the desirability (or non-desirability) of one or the other (institutions, markets) for real economic growth since at least the 1960s, a barrage of empirical works was produced in the 1990s.

Empirical evidence in the 1990s in this regard (discussed in Chapter 1) leads us to believe that financial development does indeed matter for development of the real sector. However, evidence does not support either a bank-based view or a market-based view. That is, what is important is not whether banks are important in an economy or the markets for the future growth prospect of the economy. What is important is whether the financial system of the economy is well developed or not. This is because institutions and markets provide to a large extent complementary (rather than competitive) services to the real economy.

In this respect, a few other empirical evidences need to be pointed out:

a) Institutions are more important than markets in countries with lower level of economic and financial development

b) Size of markets relative to that of institutions normally rise over time, especially for developing countries, as these countries grow in real terms.

This implies that while both markets and banks perform some unique role for any economy (developing or developed), countries at their early stages of development (i.e., the developing

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3 Keynes (1936); Robinson (1952); Gurley & Shaw (1955, 1960); McKinnon (1973).
4 That is, whether financial development is a handmaiden (i.e. faithful follower) of economic development or influences economic development.
5 Reasons explained in Gertler (1988).
countries) depends more on institutions than on markets. As countries develop, the role of markets keeps on increasing relative to that of banks.

However, it is well known (in the theoretical as well as empirical literature) that institution-based financing is heavily leaned towards debt capital, is based on size of balance sheet, and generally averse to provision of risk capital. Although markets and institutions may have some complementarity in their role in economic growth, the former is likely to be more important for an economy (like India) whose growth and real GDP depend overwhelmingly on services sector\(^6\), with some high-risk areas (like software and other information technology enabled services [ITeS] from BPO to high-end analytics, biotechnology, etc.) being the most important among the sunrise sectors\(^7\).

Thus, we observe that both markets and institutions are important for a developing economy like India. Literature suggests that financial structure of an economy (i.e., whether it is bank-based or market based) does not matter. What matters is the level of financial development. This leads one to ask the question that what determines the development of the financial sector in an economy. We have answer to this question as well. Recent studies have argued and confirmed that legal framework plays an extremely important role in the development of financial system (both the institutions and markets) of a country. Particularly, efficient laws and effective enforcement are essential components of a good legal framework that is conducive to development of financial system\(^8\). Two most important aspects of the relevance of legal framework for financial development are the protection of creditors’ rights and protection of

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\(^6\) Except in a few areas (e.g., telecom), the amount of real asset (and hence size of balance sheet) is extremely low relative to the value of output generated by service sector firms.

\(^7\) Whatever external finance has been raised by the software & ITeS companies operating from India has been raised primarily from the markets by way of equity as data available from Prowess database of CMIE shows.

\(^8\) For example, India has a satisfactory system of laws and regulations (coming as it is from the common law tradition), but enforcement is extremely poor. Press reports often quote a figure of 30 million cases pending in Indian courts of various levels.
investor rights. When creditors’ rights are protected, creditors (i.e., banks) would be more forthcoming in advancing credits to riskier (and hence, larger, number of) borrowers. When rights of investors, especially external investors, whether small or institutional, are well protected, external equity finance would be available to not just the very large and highly reputed firms with long history, but to more numerous medium or small, young firms (with good projects) as well.

Apart from the effectiveness of the legal framework, other factors have also been emphasized by Levine (2004) and Merton and Bodie (2004). They argue that growth-optimizing mixture of markets and banks (or institutions) depends on legal, political and regulatory factors, and hence, the same is different for different countries, and different for different time periods for a particular country. Our perception is that the growth-optimizing mixture of markets and banks for India at current juncture is leaned slightly more towards markets than the banks/institutions. This is because India is not only dependent on the services sector for a substantial share of her GDP and employment since at least the 1980s, the country has acquired distinct competitive advantage in certain services on a global scale.

Accordingly, we choose to explore the role of markets in developing economies in further detail, even though the role of institutions (specifically banks) in such economies may still be important. Apart from the role played by the markets in market-based developed economies,

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9 External investors are those who do not have managerial control, or “controlling stake”, à la La Porta, Lopez-De-Silanes and Shleifer (1999).

10 Services sector in India spans much beyond the telecom, banking an insurance sectors, and includes millions of small and medium service providers selling services of repairs, transport, record-keeping, tourism (excluding big hotels or chain of hotels), consultancy services, unorganized retailing, construction, and so on. According to press reports, each of unorganized retailing and construction sector provides employment to 40 million individuals.
the markets in general, and stock markets in particular\textsuperscript{11}, play a significant role in developing economies.

We observe that both the primary and secondary segments of stock market have registered tremendous growth all over the world, both in absolute terms and relative to macro aggregates like GDP, especially during the 1990s. While the growth in primary segment has been witnessed for both emerging markets and developed markets, the growth has been concentrated to primary equity market for the former (emerging markets), and to the secondary market (both debt and equity markets) for the latter. The spurt in growth in the secondary markets has been witnessed almost across the world, barring the countries belonging to lowest per capita income category.

Thus, the phenomenal growth of stock markets leads one to ask the role of stock markets in general, and their role in emerging markets in particular.

We find that in a developing economy, markets provide long-term risk capital on ownership basis (mostly equity) that is not otherwise available (because institutions mostly provide debt capital). Markets also provide certain benefits to the local investors (ability to diversify their portfolio and to take exposure on foreign markets or on MNCs having local business as well). Markets may be geared towards attracting foreign exchange inflow (as had been happening in India until 2003)\textsuperscript{12}. In certain cases, markets have also facilitated the process of privatization of inefficient public sector enterprises\textsuperscript{13}.

\textsuperscript{11} Public capital (stock or debt/bond) market in developing economies normally focuses on equities, and normally does not focus on debt.

\textsuperscript{12} The eagerness to attract foreign portfolio investment may land a country into the problem of managing excess liquidity and the consequent impact on inflation and interest rates as has been happening in India since 2003.

\textsuperscript{13} There exists an extant literature in this regard taking queue from Britain’s experience under Mrs. Thatcher. But what we have in mind here is the Indian experience, which is quite different from the experience under “Thatcherism”.
We also observe that stock markets play a special role in emerging markets. Apart from providing long-term finance to industry (which is otherwise scarce in supply in developing economies), stock markets are the only source of external equity in such countries where venture capital industry is underdeveloped, and institutions normally do not take equity participation (unlike as in Germany). When a developing country emerges out of financial repression and adopts financial liberalization, stock market provides valuable information that helps agents to price the risks of projects in efficient manner. Stock markets in emerging economies exert competitive pressure on the traditionally dominant banking system, which is often characterized by state monopoly, and help to improve their efficiency and service standard. As the long-term bond market is underdeveloped in most developing countries, certain financial institutions (like insurance companies, pension funds, etc.) suffer from the non-availability of financial instruments to park their long-term funds. Consequently, such institutions are forced to park their long-term funds in short-term instruments yielding very low return. Stock markets in such economies at least partially fulfill this lacuna by providing an avenue for investing long-term funds to generate higher expected return (commensurate with risk). Emerging economy stock markets can also be a source of foreign exchange as has been demonstrated by the experience of the Asian tigers since the 1980s and 1990s and India since the mid-1990s. However, this aspect of stock market in emerging economies has to be dealt with caution, as this could also be a potential cause of macroeconomic disturbances in an otherwise stable economy triggered by transmission of financial shocks emanating in a different country (the so called “contagion effect”).

After analyzing the role of stock markets in an emerging economy, we focus on the primary market for equities. However, this is far from being even implicitly assuming that the secondary market is not important. In fact, the secondary market cannot exist without a primary
The maiden public issue by a privately held firm (followed by listing for the first time on a stock exchange) is known as the initial public offering (IPO). The decision by a privately held (i.e., hitherto non-listed) firm to issue equity to the public and get listed on a stock exchange depends on a variety of factors. Literature suggests that the most important reason for going public is securing equity finance. Other motives for going public include enhancing company image and publicity (at the time of public issue), motivating management and employees (through stock option schemes) and enhancing the liquidity of investments made by the original owner (by admitting the possibility of selling out the stakes of the original owner in the market after public listing). However, the motivation for going public may also include the objective of exploiting the temporary windows of opportunity whereby current owners may issue overvalued equity to the public when the market as a whole is attaching a higher than warranted valuation to companies offering equity to the public, thus causing a wealth transfer from the new investors to the original owners.

Thus, any country with a stock exchange (and hence, by implication, with a secondary market) must have a market for IPO. Over the years starting from the late-1960s, three apparently anomalous empirical regularities (or irregularities) with respect to IPOs have been observed. First, IPOs are underpriced in the short run, i.e., return from offering price (at offering date) to listing price (at listing date) for IPOs is on average positive after taking into account the movement of the market during the period between offering and listing. This empirical observation has been found in “any country with a stock market”. Second, available empirical evidence suggests that the market for IPOs exhibit cyclical trends with respect to number of
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IPOs, amount (in real terms) mobilized through IPOs, and initial underpricing. Third, it has been reported that IPOs generate poor long run return compared to the overall market (measured by a market index consisting of the largest and most liquid stocks) as well as to the comparable firms (in respect of size and book-to-market ratio) that did not make any IPO during the preceding period (of three or five years, depending up on the length of horizon over which “long run” performance is measured).

In this work, we have studied both the short-run underpricing and long run performance of a sample of over 2000 IPOs that got listed during an exceptionally active phase of Indian IPO market in the early 1990s that followed a large dose of liberalization. While the extent of initial underpricing is high by international standard, we find that these IPOs do not exhibit long run underperformance compared to listed firms of similar size not making any IPO during the preceding three-year period. However, IPOs indeed exhibit long run underperformance when compared to the market. That is, investor experience with IPOs in the long run is found to be poorer than the market in the long run, but not any poorer than the size matched, non-IPO (control) firms.

We find that some of the important pre-IPO firm characteristics that were held by the press and the investors as desirable did not have much influence on either underpricing or long run performance. In fact, whether an IPO is at all appraised or not (by any entity – a bank or a DFI or an NBFC) did not have any influence on short-run underpricing but was associated with poorer performance in the long run. This implies that the representative investor (who did not get any allocation at the time of IPO allotment, but purchased the IPO on listing) would have done better if she had invested in un-appraised IPOs than if she had invested in appraised IPOs.
What was observed consistently is that the ownership retention by the original promoters is positively associated with both initial underpricing and long run performance.

One interesting observation of this study is that size of firms (at the time of making IPO) does not matter for either short run or long run performance. Neither the market share of merchant bankers bringing these firms to the public market matters so long as long run investor experience (compared to non-IPO firms of similar size) is concerned\textsuperscript{14}.

Market conditions during the period between offering and listing\textsuperscript{15} was found to exert strong negative influence on both short run underpricing and long run underperformance. That is, results show that if the market condition during the period between offering and listing is characterized by boom like situation, IPOs are underpriced less, and their long run performance (measured by buy-and-hold abnormal return compared to BSE-30 index) is better (or less worse), than if the market condition during the same period is characterized by bear like situation. This evidence certainly supports the hypothesis of (some sort of) investor irrationality. In view of existing knowledge, this evidence lends credence to the divergence of opinion hypothesis, which is also a model (among many other possible ones) of investor irrationality.

\textsuperscript{14} Market share of lead manager was found to be insignificant for short run underpricing as well, though the results were not shown.
\textsuperscript{15} Our sample exhibits a median listing delay of 80 days, or just above 11 weeks.
6.2 Market for Small Stocks

Our analysis has shown that proportion of resources of the banking sector channelized towards large and medium-size enterprises has been declining over the years. A programme to facilitate provision of institutional credit to the small and tiny sector was provided since the late 1970s under the directed lending programme. Whether that programme achieved the desired level of success or not has been subjected to considerable research. But one claim can be made beyond doubt – organized efforts were made to provide institutional credit to the small and tiny sector of the industrial landscape. So long as an effort is not made, the question of effectiveness or adequacy of any such effort does not arise.

As per theoretical predictions, and as has been well known, large and very large firms do not face much difficulty in raising external capital – debt (external commercial borrowing, domestic borrowing from institutional sources, private placement, etc.) or equity (American or European or Global depository receipts/shares, public capital market, market for privately placed equity, etc.).

What was ignored had been the filler of the sandwich – the medium-sized enterprises. They declined in importance over the years in respect of credit from the banking sector. In the early 1990s, after the entry norms were completely liberalized, a large number of medium size firms\textsuperscript{16} were able to raise external finance from the public capital market\textit{freely} for the first time since the Defense of India Regulations (DIR) were issued during the Second World War.

\textsuperscript{16} According to definitions adopted by governmental agencies/authorities, small firms are those with a firm size of Rs. 2 crore (investment in plant and machinery excluding value of land) or less, which was revised to Rs. 5 crore in 2002. The medium size firms are the ones with size larger than the small firms. For a long time, there were no regulatory limits defining medium size firms. What appears that much of what is referred to as “small firms” in the context of size of firms making IPOs is actually the medium-size firms when we take a broader view of firms across all size categories in the economy.
Contrary to popular belief (including press, regulator, and ministerial departments) that these small (by stock market standard, and medium by the broader standard) firms were the main culprit (that these firms raised equity from the “gullible investors” in a booming market, and then did not deliver, and some of them actually vanished from the scene) were refuted by our evidence. Although a little more than 200 firms actually vanished from the scene (out of 4000 odd firms that made IPOs during the 3/4 years in the first half of the 1990s), an impression was created that all small (or medium) firms were responsible for the opportunistic behaviour (and were devoid of any good project requiring risk capital financing), who were brought to the market by small-time private merchant bankers, who were often termed as “fly-by-night” operators.

Developments in the regulation of primary market during the second half of the 1990s focused primarily on size of firms making IPOs as well as size of lead managers bringing these firms to the public capital market. Effectively, the door of public equity market was closed to the medium-size firms, and the smaller merchant bankers were thrown out of business through regulatory changes.

Attention was not paid to generate awareness among individual or retail or small investors about the basic principles of stock market investing (one important aspect being the size effect). If a certain class of investors (e.g., small or retail investors) is investing irrationally excessively in a certain class of assets (e.g., IPOs, which were essentially like other non-IPO stocks of similar size), such investors need to be made aware of the risks of this class of asset (i.e., small stocks) as well. If there is some ignorance on the part of the numerous retail or small investors, regulator has to take care of that. But ignorance of (especially small and retail) investors cannot be a “taken for granted” assumption or basis for regulatory action. If that happens, results are likely to be what has occurred in Indian IPO market since the mid-1990s – entry barriers were
raised sufficiently to exclude medium firms from accessing the equity market. Had this happened in 1991 or 1992, India would not have seen an Infosys (of Nandan Nilekani, Narayan Murthy, and so on).

This implies that if India has to nurture the future Infosys’s (from whatever industry – software, biotechnology, food-processing, leather, chemicals, gems & jewelleries, iron and steel, or a yet to be born sector/industry), a window for medium (and small) firms to raise equity capital from public market must be made available.

Several developed countries have attempted to establish separate markets for small, growth stocks over the years starting from NASDAQ (founded in 1971) and Japanese counterpart of NASDAQ, JASDAQ (found in its original form in 1963, but revamped in 1976). In the 1990s, a number of European countries have attempted to establish the “junior markets”, focused on small and technology stocks (Table – 1).

While NASDAQ and JASDAQ, the oldest ones, have charted different paths, and both become successful, the attempts of European countries in the 1990s have not met with much success. Of these, the Alternative Investment Market (AIM) of UK has been the most successful one, while the Neuer Markt of Germany ultimately failed within five years of its birth after attaining spectacular success.

The success and failure of Neuer Markt had much to do with primarily two aspects. The market focused solely on technology stocks from IT area, which was also the primary reason behind its impressive growth. However, the same factor also brought it down after the technology (or dot.com) bubble burst in 2000. On the other hand, the AIM survived the turbulence of 2000 because it did not focus on one sector.
Most countries that sought to establish junior markets almost always tended to impose similar regulatory restrictions and compliance requirements on the junior stocks as applicable to the main market meant for large stocks. The reason is primarily to protect investor interest. However, this is likely to defeat the purpose of providing easy access of equity finance to small and medium companies, because the transaction costs become too high relative to the size of these companies. AIM has been an exception to this practice. This is not to argue that lower entry barriers for small companies were the reason for success of AIM, because there were (and might be) other factors as well. What we intend to point out is that a higher transaction cost for raising equity (imposed by similar entry norms and compliance requirements as applicable to the large companies for listing in the main market) will certainly defeat the purpose of a junior market.
Table 6.1: Markets for Small Technology Stocks across the World

<table>
<thead>
<tr>
<th>Market</th>
<th>Country</th>
<th>Date/Year of Establishment</th>
<th>Focus/ Purpose /Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third Market 1,a</td>
<td>England</td>
<td>1987 (January)</td>
<td>Flopped in the wake of 1987 stock market crash, and was closed in 1990.</td>
</tr>
<tr>
<td>Unlisted Securities Market (USM) a</td>
<td>England</td>
<td>1980</td>
<td>Set up by London Stock Exchange to cater to small companies, but achieved only limited success. Acceptance of new listings was stopped and the market was closed in 1996.</td>
</tr>
<tr>
<td>Alternative Investment Market (AIM) b</td>
<td>England</td>
<td>1995 (June)</td>
<td>It was established in a renewed attempt to set up a market for small stocks. Unlike the official or main/broad market of LSE, it does not impose any requirements for minimum trading period or number of shares in the public b.</td>
</tr>
<tr>
<td>Second Marche (Second Market) a</td>
<td>France</td>
<td>NA **</td>
<td>Intended for companies that are not large enough to be traded on the Official Market; considered as an intermediate stage for medium companies that would transcend or be upgraded to the main official market. This has been largely unsuccessful.</td>
</tr>
<tr>
<td>New Market (Le Nouveau Marche) a</td>
<td>France</td>
<td>1995 (Feb.)</td>
<td>Targeted towards small, relatively young, high-risk growth companies from high-tech fields. Allowed listing with relaxed requirements.</td>
</tr>
<tr>
<td>Euro NM 2</td>
<td>France</td>
<td>1996 (March)</td>
<td>Dedicated to growth companies, regardless of sector/activity/country of origin. It is a pan-European market consisting of member exchanges and their respective new markets, e.g., Paris Stock Exchange (Le Nouveau Marche), Deutsche Borse AG (Neuer Markt), Amsterdam Exchanges (NMAX) and the Brussels Stock Exchange (Euro.NM Belgium)</td>
</tr>
<tr>
<td>Regulated Market a</td>
<td>Germany</td>
<td></td>
<td>Intended for smaller companies with issues value under DM 500,000.</td>
</tr>
<tr>
<td>New Market (Der Neuer Markt or simply Neuer Markt) a</td>
<td>Germany</td>
<td>1997 (March)</td>
<td>Established following the success of French Nouveau Marche. Focused primarily on IT stocks, boomed until 2000, but failed on the eve of global technology meltdown. Finally closed in 2003, six months earlier than expected.</td>
</tr>
<tr>
<td>Bourse de Bruxelles 3</td>
<td>Belgium</td>
<td>1999 (April)</td>
<td>Set up on the line of and following the French Nouveau Marche.</td>
</tr>
<tr>
<td>JASDAQ a,a</td>
<td>Japan</td>
<td>1976</td>
<td>An OTC market</td>
</tr>
<tr>
<td>MESDAQ a</td>
<td>Malaysia</td>
<td>1997 (October)</td>
<td>Mostly for technology-based companies</td>
</tr>
<tr>
<td>SESDAQ a</td>
<td>Singapore</td>
<td>1987</td>
<td>For small and medium sized companies of Singapore</td>
</tr>
<tr>
<td>Canada a,a</td>
<td>TSX Venture Exchange/ CDNX a</td>
<td>1999 (November)</td>
<td>Provides Venture companies with effective access to capital while protecting investors. It is home to basically small cap stocks.</td>
</tr>
</tbody>
</table>


*: Canadian Venture Exchange was established in 1999, but was taken over by TSX Group in 2001.

**: Could not be ascertained by the current researcher.
If the junior market allows easier entry norms and regulatory requirements for small and medium companies, then the question that arises is how to protect investor interest, especially interest of small investors. While it is a subject matter of further research, two aspects are important. First, proper protection of investors against expropriation by controlling stake holder (or the promoter) is extremely important\textsuperscript{17}. Second, protection of rights means not only efficient laws, but effective implementation of the laws as well.

Lessons learnt from Neuer Markt of Germany during 1997-2003 (a story of failure) and the Alternative Investment Market (AIM) of the UK (a success story till date) suggest that stricter regulation for smaller firms are more likely to meet with failure than otherwise. Rather, entry barriers stipulated by regulation should be more liberal for small/medium firms, but listing and after-market trading of such firms should be distinguished from those of already established large firms.

The basic problems of operationalizing a separate market (either independently or as a second market under an existing main market like BSE or NSE) are: (a) how to ensure that merchant bankers, of whatever size, actually perform their role of appraising a project and bringing to the market IPOs that are truly promising irrespective of the size of such firms/IPOs and risk of projects sought to be financed through IPOs by these firms (given that the extent of risk is properly disclosed), (b) how to protect the interest of the small investors, given that these investors are led more by market sentiment than by rational and persistent factors like size effect.

Given the results reported by La Porta, Lopez-De-Silanes, and Shleifer (1999), we now know that firms across the world are primarily held under the family ownership. The standard Berle

\textsuperscript{17} See, for example, Burkart, Gromb and Panunzi (1997), Shleifer and Vishny (1997), Claessens et al (1999).
and Means (1932) setting of separated ownership and management is valid only in the US and the UK. India is no exception to the overall global trend: most large Indian firms and almost all medium and small firms are held under family ownership. Consequently, the problem of minority shareholder expropriation becomes acute in this case.

6.3 Conclusion/ Policy Implications

Turning back to specific results from our study, the following aspects need regulatory consideration:

- The role assigned to the appraiser is of little relevance. It should in fact be the responsibility of the lead manager even for fixed-price offerings. The individual investors (not being proprietorship/partnership firm or private/public limited company) should be provided with the facility of bringing investor lawsuit (if required, jointly) against IPO firms and/or lead managers – so that lead managers and/or the IPO firm may be taken to court (e.g., as in the US) if long-run performance turns out to be extremely poor. Although this may initially give rise to a few frivolous lawsuits, over time a standard is likely to evolve that can be used to a priori reject the frivolous cases as has happened in case of “Public Interest Litigation” (PIL) suits in India in recent past.

- Size of IPO firm is not an important determinant of either initial underpricing or long run performance (investor experience). This implies that size of firm or size of offering should not be an entry barrier to making IPOs (and getting listed on a stock exchange) imposed by regulatory stipulations. However, instead of lowering entry barriers for across the market, it would be better to offer an alternative window for small and medium firms. This is because the regulatory and developmental focus can then
concentrate more on this small market, than spreading resources thinly across the entire market.

- Regulatory focus should (not be on size of firm making IPO and should rather) focus on the skill and ability of the most important market intermediary in this respect, the lead merchant banker, to filter out IPOs of poor quality (irrespective of size) and allow good quality firms to reach the public market.

- Reputation of lead manager (measured by in-sample market share) taking firms to the IPO market is of not much relevance for either short run underpricing or long run underperformance (measured by BHAR against BSE-30 index) after controlling for factors like appraisal status and appraiser entity, firm size, par or premium issues, post-IPO promoters’ stake, and so on. That is, our result suggest that regulatory focus should not concentrate on the size of the financial intermediary acting as lead manager; rather it should focus on the ability to trace the promoters and top employees of merchant banking firms and IPO firms in case a lawsuit is brought against a lead manager/ firm making IPO\(^\text{18}\).

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\(^{18}\) This might as well mean imposing additional restrictions in terms of PAN card, voters’ identity card and passport, besides verification of permanent address, schooling details of children, professional and permanent address details of immediate relatives like spouse, brother/sister, parents, and respective in-laws, and so on. This will automatically create what is called “non-tariff barriers” in the parlance of international trade, that is likely to screen out a lot many fly-by-night operators purporting to operate as lead manager taking firms of dubious quality and intention to the public equity market.
6.4 Areas of Further Research

While surveying the literature, setting up hypotheses and interpreting results, we have focused on both theoretical literature and empirical evidences. Our quest on empirical literature focused on three aspects – studies pertaining to (carried out in respect of or using data from) developed countries, developing countries in general, and India in particular. We have found that empirical evidences concerning India are far from plentiful (going by publicly available sources like books, journals and websites).

Our findings have prompted us to delineate certain areas/fields for further research using data Indian data. Of these, we point out those that appeared relevant to us from a futuristic point of view:

(A) How to make the main market more efficient

(B) How to integrate the nascent venture capital/ private equity market with the public stock market, especially for small and medium stocks (not limited to high-tech firms only)

(C) If, and when, a market (or a separate segment) for small/medium stock (i.e., a junior market) is created, how to (i) protect the interest of small investors; (ii) how to ensure a steady inflow of small/medium firms into the junior market (availability of finance is one of the many problems faced by small/medium stocks; other problems need also to be solved).

(D) Which ownership structure should the Government encourage for larger and medium enterprises – family-ownership or professional ownership? As each of these systems has its own advantages and disadvantages, and different implications for protection of
investor interest, one needs to find out which of these systems is more suitable for India at the current juncture.

(E) Implications of allocation (or allotment) mechanism adopted in India in view of evidences across the world \(^{19}\) – for main market as well as for junior market (in case it is set up).

(F) Implications of the mutual funds and foreign institutional investors (FIIs) for the primary market.

(G) Whether empirical regularities of IPOs of 1993-96 are also found for IPOs of post-1996 period, as also whether there is any difference regarding these empirical regularities between fixed-price and book-built IPOs in the post-1999 period (when book-building was allowed in the IPO market in India).

(H) Extent and nature of retail participation in Indian stock markets – why retail participation is important for the primary market, and what should the retail/individual investors do for medium to long term investment in equity (direct or indirect participation through mutual funds).

\(^{19}\) See, for example, Sherman (2000) Sherman and Titman (2002), Jagannathan and Sherman (2005), and Sherman (2005).
References


