CHAPTER 9
SUMMARY, FINDINGS AND CONCLUSIONS

9.1 INTRODUCTION

Primary capital market provides opportunity to corporate bodies to raise necessary funds from different category of investors through issue of both debt and equity securities. Investors commit their surplus funds with the objective of earning a rate of return on the basis of disclosures made in the offer document. The whole process of funds mobilisation is completed with the active involvement of various professional agencies which provide their specialised services to the issuer company. With the implementation of new industrial policy of ‘Privatisation, Liberalisation and Globalisation of Indian Economy’ in 1992, many capital market reforms were introduced to increase the pace of funds mobilisation. With the lifting of CCI control over the capital issues in 1992, a new era of market determined mobilisation of resources began in India under the supervision of a new regulator named ‘The Securities and Exchange Board of India’ (SEBI). Issuer companies got freedom to price their public issues of securities with the consultation of issue managers and subject to the compliance of SEBI’s DIP guidelines and relevant provisions of Companies Act, 1956. As a result of change in market scenario, the primary capital market of India created new records of growth in terms of total resources mobilised and number of public issues but it has given birth to new problems which need to be addressed in order to protect the interest of the investors in the market.

9.2 REVIEW OF LITERATURE

9.3 NEED FOR THE STUDY

It emerged from review of literature that most of the studies conducted on primary capital market had focussed on measuring listing day performance of IPOs. Few studies have been conducted to measure the long-run performance of IPOs. Enough work has not been done to evaluate the performance of different types of public equity issues. The determination of fair offer price of equity issues has become a hot and debatable topic among the academicians and market experts. No past study has compared the performance of fixed price and book building equity issues so as to find out a better method of equity issues pricing in India. During review of literature, it was noticed that no research work has so far been conducted to study the disclosure practices in the offer documents of the issuer companies. Equity is a risky investment as the return is dependent on numerous factors. The impact of offer document disclosures and market return on equity issues return needs to be examined as this aspect has not been covered by the previous studies on primary capital market. The effect of bonus issue, rights issue and stock-split has not been incorporated in the rate of return used in past studies on primary capital market. In order to fill the gap and seek answer to the aspects stated in the paragraph, the present study has been conducted.

9.4 OBJECTIVES OF THE STUDY

The present study has been carried out to achieve the following specific objectives:

1. To study the pricing mechanism of equity issues in India and to compare the return of book building equity issues with the return of fixed price equity issues;

2. To study the disclosure guidelines and practices in the offer documents of the issuer companies with respect to Risk Factors, Issue Highlights, Justification of Issue Price, Objects of the Issue, Means of Finance and Project Appraisal;

3. To evaluate the performance of different types of equity issues in the short-run and medium to long-run;
4. To examine issue size-wise, issuers' age-wise, industry-wise and merchant bankers-wise performance of equity issues;

5. To examine the impact of offer document disclosures and market return on equity issues return and

6. To study the effectiveness of the mechanism of investors’ protection in India and to suggest the measures required to resolve the problems of investors in the primary market.

9.5 DATABASE AND RESEARCH METHODOLOGY

Research methodology covers universe of the study, sample size, selection of sample, its description, sources of data collection, tools and techniques used for the analysis and presentation of the data and limitations of the study.

1. **Universe of the Study:** All public equity issues of the size of Rs. 10 crore and above floated during the period of 12 financial years from 1992-93 to 2003-04 are 484 (approximately), which mobilized funds to the tune of Rs. 53,245 crore. All these issues comprise universe of the study.

2. **Sample Size:** In the present study, a sample of 322 public equity issues have been taken which mobilized funds amounting to Rs. 38,371 crore. The size of the sample is 67% of the universe of the study on the basis of number of issues and 72% on the basis of resources mobilized.

3. **Selection of Sample:** The selection of equity issues for the sample is influenced by the availability of offer document and share price data of the issues with Bombay Stock Exchange.

4. **Description of Sample:** The Public equity issues covered by the study comprise 51 Par IPOs, 178 Premium IPOs, 62 Further Issues of equity shares and 31 Offer For Sale(OFS)/ Offer For Sale with Fresh Equity Offerings(FEOs) type of issues.

5. **Sources of Data Collection:** The study, being empirical in nature, has to rely primarily on the secondary data which was obtained from offer documents/red-herring prospectuses of companies, BSE Official Directories for the years 1992-93 to 1996-97, Annual Reports of SEBI for the years 1996-97 to 2006-07, ‘Handbook of Statistics on the Indian Securities Market’ of
SEBI for the years 2006-07 and 2007-08, Annual Reports of RBI for the years 1998-99 to 2007-08, ‘Reports on Currency and Finance’ of RBI for the years 2005-06 and 2006-07, Prime Database Annual Reports for the years 1992-93 to 1995-96 and from different journals and financial dailies like Capital Market, Dalal Street, Chartered Financial Analyst and Economic and Political Weekly, The Economic Times and Financial Express etc. Besides this, the Prowess Database and Capital-line database have been used for collecting necessary data for the study. Data regarding first trading day of sampled equity issues, record dates of bonus issues, rights issues, stock-splits and investors’ complaints have been collected from the ‘Filing Department’ and ‘Investor Services Department’ of Bombay Stock Exchange.

6. Tools and Techniques Used for the Analysis and Presentation of the Data:

i. Rate Of Return Analysis: Simple as well as annualized adjusted rate of return has been found out at six points of time i.e. on first trading day of the issues, after 3 months, 6 months, 1 year, 2 years and 3 years from first trading day of the issues on Bombay Stock Exchange (BSE). In the present study, the rate of return has been adjusted for the effect of bonus issue, rights issue and stock-split decisions implemented by the sampled companies within 3 years from first trading day. For analysis of different types of equity issues, tables of market return slabs with an interval of 25% have been constructed. The performance of fixed price and book building issues has been evaluated on the basis of rate of return obtained by the investors at different points of time covered by the study. The individual as well as comparative performance of different types of issues in the short-run has been evaluated on the basis of simple rate of return obtained by the investors at first trading day and after a period of 3 and 6 months from first trading day of the issues on BSE. The medium to long run performance of different types of equity issues under study has been examined on the basis of annualized adjusted rate of return obtained by the original allottees after 1, 2 and 3 years from first trading day of issues on BSE.

ii. Average and Percentage Analysis: Statistical tools like average and percentage analysis have been used for the purpose of analysis of data.
Issue size-wise, Issuers’ age-wise, Industry-wise and Merchant Bankers-wise performance of issues have been evaluated on the basis of average return.

iii. **Measurement of Risk**: Element of risk has been measured on the basis of coefficient of variation.

iv. **Tabular Analysis**: Simple as well as Two-way frequency tables have been prepared to analyze the data relating to disclosure practices.

v. **The Linear Multiple Regression Analysis**: Statistical technique of Linear Multiple Regression Analysis has been used to measure the individual and combined impact of offer document disclosures on first trading day return as well as average return.

vi. **The Simple Linear Regression Analysis**: This technique has been applied to measure the impact of market return on equity issues average return during the period under study.

vii. **Bar Charts**: Besides this, bar charts have been prepared to highlight the results of the study.

9.6 **FINDINGS OF THE STUDY**

The major findings of the study are as follows:

1. The present study finds that the original allotees obtained positive return from 83%, 55%, 57%, 58%, 52% and again 52% book building issues on the first trading day, after 3 months, 6 months, 1 year, 2 years and 3 years from the first trading day of the issues on Bombay Stock Exchange respectively. Contrary to this, equity investors obtained positive return from 74%, 55%, 49%, 37%, 24% and 17% fixed price issues on the first trading day, after 3 months, 6 months, 1 year, 2 years and 3 years from the first trading day of the issues on Bombay Stock Exchange respectively. These return percentages have led to the conclusion that book building is a better method of equity share pricing than the conventional fixed price method. However, book building method could not completely solve the problem of negative return but it has certainly helped the investors in obtaining positive return from more percentage of issues than fixed price issues covered by the study.
2. The study brings to light that the investment in public issues of equity shares proved beneficial for short term investors who sold out their investment on first trading day or after a period of 3 to 6 months from first trading day and proved harmful for medium to long term investors who disposed off their original allotment after 1, 2 or 3 years from first trading day as they could not recover their original investment in most of the issues covered by the study. The pains of the investors who made investment by borrowing money from the banks and financial institutions can be realised as they suffered by two ways. Firstly, they paid interest on borrowed funds and secondly they could not save their investment due to heavy losses they suffered at the time of exit from the market. It is revealed by the study that after one year period from first trading day, the pricing method had little impact on positive and negative return derived by the investors from both book building and fixed price equity issues.

3. This study finds that 100% (pure) book building issues performed better than the issues marketed on ‘75% Book Building and 25% Fixed Price’ basis and ‘90% Book building and 10% fixed Price’ basis not only in the short-run period but also in the long-run. The results of the analysis established that pure book building issues provided average return of 31.20%, 47.87%, 93.40%, 139.10%, 81.13% and 76.20% to the investors on first trading day and after a period of 3 months, 6 months, 1 year, 2 years and 3 years from first trading day respectively. The issues brought through 75% book building route failed to solve the problem of determination of fair issue price as majority of the issues were traded at market prices which were far below the offer prices discovered through book building mechanism resulting into huge losses to the investors in varying percentages at different points of time covered by the study.

4. The theoretical considerations provide a sound case in favour of price discovery through book building method due to the inherent positive features in the whole process of book building which is transparent and flexible in the sense that different bids can be made by the investors for different quantities at different prices and provides an opportunity to the investors to revise the bids before the closure of book building process. Above all, book building method
provides early liquidity to the investors because a book built issue is listed on a Recognised Stock Exchange approximately after 3 weeks/21 days (2 weeks for finalising allotment+1 week for complying with listing formalities) from book closing date compared to a fixed price issue where the issue is listed after minimum 37 days (30 days for completing allotment formalities+ 7 days for complying with listing formalities) from the closure of the issue. So, the investors in a book built issue can sell their allotted shares in lesser number of days as compared to fixed price issues and thus can use the proceeds in more profitable ventures.

5. On the basis of disclosure made in offer documents by the issuer companies covered by the study, the study finds that only 68% sampled companies made disclosure of risk factors as per SEBI’s guidelines by proper classification of risk factors into internal and external and along with the perception of the management to address them. It is revealed by the study that remaining 32% companies which mobilized funds during initial years of reforms failed to discharge their duty towards prospective investors as they have made disclosure without any classification of risk factors and the management of these companies did not chalk-out any counter strategy to face the conceived risks. Hence, they mobilized the funds in haste taking unnecessary advantage of bullish market conditions. Further, 76% sampled companies have been found in non-compliance with SEBI’s guidelines by making disclosure of risk factors on the front page of the offer document and only 24% issuers have shown the company and project specific risk factors on first inner page of the offer document.

6. There is a comprehensive list of risk factors disclosed by the sampled companies in their respective offer document. Some of the external risk factors shown by majority of the issuers include risk of change in Govt. excise/import and export/regulatory policy disclosed by 85% issuers, risk of market competition from the competing units conceived by 76% issuers, risk of fluctuation in the exchange rates shown by 46% issuers and risk of change in market interest rates disclosed by 20% issuers etc. Among the internal risk factors, 34% issuers expected delay in commencement of production due to non-placement of the order of new machinery, 30% due to non-receipt of
power/and water sanctions from the concerned authorities, 28% due to non-receipt of no objection certificate from Pollution Control Board. About 28% issuers feared fall in profitability due to the risk of time and cost over-run. Twenty three percent companies under study have shared the information with the investing public that their project may be delayed due to one reason or the other. Eighteen percent issuers raised funds from the market without obtaining working capital sanctions from their bankers. Twenty eight percent companies mobilized funds carrying contingent liabilities arising from disputes with different authorities, suppliers, customers and employees.

7. It has been found that some of the risk factors disclosed by the issuers are industry specific like risk of Non Performing Assets (NPA) shown by banking companies, availability of raw material dependent on climatic conditions shown by agro based companies, risk of non-registration of trade marks by pharmaceutical companies, risk of high attrition rate experienced by IT companies, risk of security threat, piracy and non-protection of intellectual property rights by companies in the communication/internet and multimedia industry and dependence of profitability on the performance of clients (other companies) shown by non-bank finance companies.

8. It is revealed by the study that 25% of issuing companies fighting court cases, another 17% suffering losses and showing poor financial performance, many despite being tainted by different committees were allowed to mobilize resources from the market. More specifically, 3% companies floated their public issues despite having got unfavourable report from various authorities like SEBI (for lapses committed while acting as market intermediary in public issues), RBI (for high Non Performing Assets and low Capital Adequacy Ratio), Jankiraman Committee on Securities Scam 1992 (for favouring clients in securities transactions), Verma Committee on evaluation of Banks’ strengths in 1998 (for poor solvency and profitability position) and Moody’ Investor Service (for poor deposit rating).

9. It is disgusting to note that 2% companies, under research, which were loan defaulters were allowed to tap the market for mobilization of funds. One percent sampled companies mobilized funds to pay high cost loan or to pay statutory dues even up to 50% of issue proceeds. In this way companies were
allowed to raise funds for unproductive purposes. Investors simply put their life’s savings on the advice of financial advisors and brokers and without giving any serious thought to the disclosures made in the offer documents.

10. From the disclosures made by companies in their offered documents, it comes to light that the issuer companies tried to influence the prospective investors by stating company, project and issue specific positive points under issue highlights. Among company specific points, 71% issuers disclosed that they are existing profit making and dividend paying entities. Further, 36% brought it into the notice of the investors, through disclosure, that they are run by experienced promoters, 35% associated themselves to established promoter’s group and 21% claimed themselves as leading manufacturer/service provider. In addition, 15% companies disclosed the information that they have won many prizes for excellent performance, 11% showed growth in PAT, EPS and BV, 6% disclosed favourable Capital Adequacy Ratio (CAR) and 4% claimed ISO certificate holders. Among project specific points shown under issue highlights, 29% issuers disclosed appraisal of their projects from outside agencies, 22% informed about the foreign technical collaboration in the proposed project, 15% stated low gestation period of their projects and 11% highlighted about establishing 100% EOU which, they claimed, will earn valuable foreign exchange for the company besides providing tax concessions for certain number of years. Among public issue related highlights, 74% stated that their proposed public issue of equity shares will provide easy liquidity to the investors after listing of shares on stock exchanges and 23% companies highlighted the tax concessions to the shareholders under Income Tax Act, 1961. About 21% issuers tried to convince the investors on forecasting high growth potentials of their business. In this way, we can say that the issuer companies tried their best to trap the investors into their net by highlighting themselves as the best custodian of their investment.

11. On the basis of the disclosures made by companies under research, it comes to picture that funds have been raised for different purposes and in most of the cases for more than one purpose. Establishment of new project has been found the most common disclosure made under issue objects as 43% industrial companies mobilized resources to finance their new projects followed by 31%
and 20% companies which approached the investors to implement their expansion and diversification plans. Financing working capital requirements has been shown as one of the issue objects by 36% sampled companies and 19% issuers raised funds to strengthen their capital base whereas 6% issuers tried to enhance their borrowing ability through public issues of equity shares. Twenty three percent issuers mobilized funds to update their existing infrastructure and 7% to strengthen/create the marketing network. Repayment of high cost loan/bridge loan has been one of the issue objects of 10% companies. Raising funds for such type of objects does not result into generation of new sources of income though it may be desirable from profitability angle. Association of issue object with type of industry has also been established as 4% Non Bank Finance Companies (NBFCs) raised funds to finance their credit/capital market operations, 3% banking companies floated their public issues to meet RBI guidelines and 2% pharmaceutical companies raised funds to finance their research and development activities. Meanwhile, divesting Govt. equity has been shown as one of the issue objects in case of 3% OFS type of equity issues. To get the equity shares listed and to meet the issue expenses have been disclosed by maximum 82% and 72% companies under study as one of the issue objects. However, the companies disclosed their issue objects in different hierarchy but they satisfied SEBI’s guidelines of separately disclosing the requirement of funds for fixed assets creation and for working capital requirements.

12. Out of 322 public issues of equity shares covered by the study, 270 are premium issues in case of which the issuer companies are required by SEBI’s guidelines to disclose the basis for the issue price and premium in their offer documents. As this study covered large number of issues floated after the lifting of Govt. control over the capital market when there was no restriction on the disclosure of projected financial results, majority of the issuer companies made disclosure of historical and projected financial results in support of issue price and premium. Disclosure regarding historical and projected turnover has been made by 36% and 24% issuers who tapped the market with their premium issues. It has been found that the disclosure regarding most widely used financial parameters of PAT, EPS and BV/NAV
has been made by 61%, 78%, and 70% issuer companies for different number of historical and projected years in their offer documents in support of issue premium. Further, 18%, 15%, 8%, 5% and 1% companies which made premium issues and covered by the study have given the information of historical and projected PBT, Cash EPS, PBDIT, Cash Accrual and PBIT for different number of years for the information of investing public.

Information of net worth has been provided by 16% companies and the figures of share capital and reserves and surplus have been disclosed by 49% and 35% companies. In addition, dividend history of the issuer company is highlighted by 35% companies. Few issuer companies have shown the figures of different accounting ratios to make the things simple and understandable for the ordinary investors. The accounting ratios shown include operating profit ratio, net profit ratio, return on equity capital, return on net worth, return on average net worth, debt equity ratio, interest coverage ratio and debt service ratio etc. Disclosure of growth ratios and inter-firm comparison, based on important ratios, has also been given by very few companies. Information about capacity utilization is given by only seven companies. Components of cost of production have been shown by two companies. One company, VBC Industries Ltd, even provided the figures of expected market price of its shares which on comparison with the actual market price was found exaggerated thus misleading. It has been noticed that most of the companies have provided financial results for three historical and three projected years. The study found that the new companies promoted by individual promoters or existing companies have only provided the projected financial results for three to five years.

13. Fifty one companies covered by the study, which mobilized resources during the years 1992-93 to 1994-95, provided additional information of fair price of their equity shares based on erstwhile CCI pricing formula for the information of the investors. On comparison of their issue prices with CCI fair prices, it came to picture that 48% companies overpriced their issues by charging excess premium between 1 to 200%, 28% charged excess premium between 201 to 1000% and 4% mobilized funds by bringing their issues at premium where as CCI pricing base prescribed to make the issue only at par. However,
16% of the issuers making this disclosure brought their public issues at a price which was less than CCI price between 1% to 100%.

14. Out of 71 listed companies under research and which were required to disclose the market price data of their shares for six months preceding the month of filing draft offer document with SEBI and for three years preceding the year of issue, only 49% companies have made complete disclosure for six months, 48% made partial disclosure without providing the information of volume of shares traded and 3% did not provide any data and simply stated that their shares, though listed, were not traded during the said period. The information of high and low market price of shares along with the volume of shares traded for the preceding three years have been provided by 77% companies of which 25% made complete disclosure and 52% partial disclosure without stating the volume of shares traded on high and low market price dates and remaining 20% provided the data for less than three years. Three percent companies which did not provide market price data of their shares for 6 months took similar excuse for three years reporting. From these facts it may be concluded that even companies with doubtful history and incomplete disclosure were allowed to bring public issues during the period 1992-93 to 1994-95.

15. As per SEBI's guidelines, the issuer company is required to disclose its Price Earnings (P/E) ratio based on pre-issue EPS and industry high, low and average P/E ratio for the information of the investors. This study finds that only 57% companies have made disclosure of their P/E ratio and remaining 43% did not provide any information about their P/E ratio. The companies which have given the figures of their P/E ratios have used different denominations of EPS value for this purpose. Only 36% companies used correct EPS value (as required under SEBI guidelines) and a large 56% companies used projected values of EPS for 1 to 5 years to find out the value of their P/E ratios. One issuer company, Tamil Nadu Petro Products Ltd, used average of last three years and projected five years EPS to find out its P/E ratio. Disclosure regarding industry P/E ratio has been made by 57% companies of which 17% made complete disclosure by providing the figures of high, low and average P/E ratio of the industry, 39% disclosed only industry average ratio and 1% companies disclosed only selected companies.
P/E ratios. Besides this, the issuer companies tried to justify their offer prices by stating that their EPS value discounts the offer price by a stated number where as the P/E ratio of the industry is much higher than the company P/E ratio and if industry P/E ratio is multiplied with the EPS of the company the offer would have been made at a much higher price. The study finds that the majority of the issuer companies used projected financial results to misguide the innocent investors.

16. The issuer companies have made disclosure of more than 40 qualitative factors in support of their offer prices. It has been found that a large number of factors have been shown at two places, firstly under issue highlights and secondly the same information has been disclosed under qualitative factors shown in support of the issue price in the offer document. For example, 71% sampled companies claimed themselves as existing profit making and dividend paying entities under issue highlights whereas 44% sampled companies shared the same information under qualitative factors. Likewise, 36% issuers claimed under issue highlights that the affairs of their companies are looked after by the experienced promoters and the same information is disclosed by 32% companies under qualitative factors. A similar repetition has also been noticed in the disclosure of other factors also. However, some companies made disclosure of particular information at one place only.

17. The companies which have made disclosure of their positive points under issue highlights and qualitative factors, have been found making such claims at their own level and without quoting any outside source which certified their performance. For example, 66 companies under research claimed themselves as leading manufacturer/service provider in the industry but only 15% disclosed this information providing the figures of their market share between 10 to 70% in total market demand and a high 85% made this claim without stating their market share, 73% made this disclosure from internal source and only 27% quoted external source for such claim. Likewise, 51 issuers justified their issue prices on the basis of achievement of growth targets or encouraging financial performance. However, they have used different criteria in support of their disclosure; 23% used industry ranking criteria, 18% by measuring their compounded annual growth in sales and profits, 16% based on declaration by
outside agencies etc. Here also 41% companies shared the information from internal source and 59% quoted outside source for their disclosure. Furthermore, 41 issuers whose equity issues are covered by the study, made disclosure regarding their export business; of which 29% claimed themselves as largest exporters, 24% claimed exporting to large number of countries, 20% disclosed achievement of export targets, 15% stated export of their bulk production, 5% stated exporting vide variety of products, another 5% claiming themselves as experienced exporters and 2% disclosed having firm export orders in hand. Eighty eight percent companies disclosed the information of their export business from internal source and 12% from external source.

18. The disclosure regarding high growth potentials of the business has been made by 35 sampled companies in support of the issue price. These issuers have used phrases like ‘rapidly growing industry’, ‘huge demand-supply gap’, ‘fastest growing industry’ and ‘high export potential’ to justify their claim of high growth potentials. Twenty issuers have given the information of awards/prizes /medals/certificates of merits won by them to influence and incite the investors to take favourable investment decision. Though, the issuers have given the information of awards and prizes in their offer documents but they did not elaborate the full form of the bodies and councils providing these honours. Only abbreviation of authorities has been mentioned which is beyond the knowledge of an average reader. Fourteen issuers have provided the rating of debt instruments issued by them in past stating the rating obtained, a brief meaning of the rating and its significance and the agencies which rated the instrument/s. Fourteen sampled industrial companies disclosed the figures of operating/and cash Break Even Point (BEP) in support of their issue prices; of which 4 companies provided the figures of both operating and cash BEP, 4 have disclosed only operating BEP, 6 disclosing only cash BEP and one simply stated its operating BEP at low. Disclosure of all these factors have been made mostly by those companies which mobilized resources from the market during initial years of reforms to attract good response of the public towards their public issues.

19. After the implementation of Malegam Committee recommendation, prohibiting the issuer companies from showing projected financial results in
offer document by SEBI in early 1996, a new era of standardized disclosures began in India. Issuer companies stopped providing rosy projections of financial results in their offer documents. With the introduction of book-building route, the phrase ‘Justification of Premium’ was changed with ‘Basis for the Issue Price’. Issuer companies started providing information as required by the changed guidelines. As a result of these changes, the issuer companies started making disclosure of weighted average EPS, weighted average return on net worth, pre-issue and post-issue NAV, disclosure of minimum return required on post-issue net worth to maintain pre-issue EPS and disclosure of accounting ratios of peer group. The disclosure of weighted average EPS has been made by 26% companies; of which 21% showed the figure of WAEPS based on historical EPS for three years and 5% based on historical EPS for more than three years. Same number and percentage of companies made disclosure of weighted average return on net worth.

Disclosure regarding pre-issue and post-issue NAV has been made by 23% and 14% companies respectively. This difference is due to book building issues where the issuers stated that the post-issue NAV would be known only after the discovery of issue price on completion of book building process. Fifty five percent companies which sold out their issues during 2003-04 made the disclosure of accounting ratios of the peer group.

20. A total of 257 issuers have made disclosure regarding cost of the project/funds requirements amounting to Rs. 39448 crore; of which Rs. 7928 crore (20%) has been shown by the issuers which brought 46 par IPOs, Rs. 17735 crore (45%) shown by issuers which floated 151 premium IPOs and Rs. 13785 crore (35%) by issuers which made 60 further issues of share capital. Barring OFS issues, the remaining companies, mostly banking and NBFCs, simply stated that the issue proceeds after meeting the issue expenses will be used for regular business activities.

21. On the basis of the disclosure made, it is concluded that the issuer companies intended to meet their funds requirements from large number of sources but in different proportions. The promoters’ equity contribution towards means of finance comes out to 17%, 8% and 3% in case of par IPOs, premium IPOs and further issues of share capital whereas the equity contribution of public
amounted to 9%, 23% and 18% respectively. From these figures the bad intention of the promoters is highlighted because their equity contribution is maximum in case of par IPOs and minimum in case of further issues of share capital (which were floated at heavy premium) where as public equity contribution towards project financing is minimum in case of par IPOs and maximum in case of premium IPOs. Promoters kept large proportion of shares in par IPOs for themselves and offered maximum shares to the public in case of premium IPOs.

Project financing through external borrowings from banks and financial institutions (both Indian and foreign) was shown at 29% in case of par IPOs, maximum 33% in case of premium IPOs and minimum 14% in case of further issues of share capital. In this way, the promoters of premium IPOs heavily depended on external borrowings for financing their projects. Financing through issue of other securities (both debt and equity) was shown at 26% in case of par IPOs, 16% in case of premium IPOs and 10% in case of further issues of share capital. Further, a large 26% funds requirement was shown to be funded from internal accruals in case of further issues of share capital, 7% in case of premium IPOs and minimum 1% in case of par IPOs. It means that the companies which brought further issues of share capital depended heavily on internal accruals for financing their issues objects. Other sources of finance like lease finance, fixed deposits and security deposits, Govt. subsidy and current liabilities have also been shown as sources of finance which amount to 3% in case of further issues of share capital, 5% in case of premium IPOs and a high 11% in case of par IPOs. In case of par IPOs, the issuers proposed to meet 10% of their funds requirements from current liabilities (credit from suppliers, hire purchase and instalment credit etc.) and remaining 1% from lease finance.

22. After examination of the offer documents, it is concluded that only 182 i.e. 60% sampled companies got their projects/funds requirement appraised from outside agencies and the remaining 40% mobilized necessary funds without appraisal of their projects from outside agencies. From 182 sampled companies which got their projects appraised from outside agencies, 84(46%) have stated that their appraising agency is not participating in the means of
finance which implies that there is no monitoring of funds raised through public issues by the appraising agencies in case of these companies. The issuer companies which got their projects appraised from outside agencies have approached different agencies as 54% projects have been appraised by development banks, 27% by public sector banks and their subsidiaries, 6% by non-bank private sector appraisers, 4% by Technical Consultancy Organisations (TCOs), 3% by State Govt. undertakings, another 3% by private sector banks and their subsidiaries, 2% by foreign banks and 1% jointly by public sector and private sector banks. From these percentages, it is evident that development banks have been the first choice of the issuer companies followed by public sector banks.

23. Projects of the estimated cost of Rs. 28524 crore have been appraised by different agencies, but surprisingly only Rs. 1881 crore i.e. 7% of total estimated cost was agreed to be funded by the appraising agencies. Though development banks participated in 79% of the total number of projects appraised and to the extent of Rs.1421 crore but it is only 9% of the total estimated cost of Rs. 14973 crore of projects appraised by them. Maximum participation of 14% has been shown in case where projects were jointly financed by public sector and private sector banks. Appraising agencies like Technical Consultancy Organisations, foreign banks and non-bank private sector, though, appraised some projects but they did not participate in the means of project finance. On the whole, it may be said that appraising agencies either did not join the issuers in project financing or their participation was marginal or negligible. Hence, it may be concluded that majority of the appraisers provided only fee based technical services of project appraisal but hesitated to provide finances for the same and in this way gave free hands to the issuer companies to deploy the issue proceeds at their own discretion.

24. Appraising agencies agreed to participate in project funding by providing different types of finance. Out of Rs.1881 crore of project funding by appraisers, 81% was shown to be financed in the form of rupees term loan, 15% in the form of foreign currency loan, 2% against issue of Non-Convertible Debentures (NCDs) and 1% by way of lease finance. It has been
noted that only development banks agreed to extend finance against issue of NCDs by the issuer companies. It is concluded that from the various forms of borrowings, rupees term loan borrowing has been shown as the most preferred choice of the issuer companies.

25. The analysis of different types of equity issues on the basis of average return reveals that par IPOs performed better than premium IPOs and further issues of share capital at all points of time covered by the study. From among premium IPOs and further issues of share capital, premium IPOs provided better return to the investors than further issues of share capital. This study finds that the further issues of share capital performed very badly with less initial return and highest negative return, on per annum basis after two and three years from first trading day of the fresh equity on BSE. The study reveals that the OFS type of equity issues provided positive and rising return to the investors up to one year period and maximum return among all types of equity issues, under study, after three years from first trading of the issues on BSE.

26. The performance of different types of equity issues on the basis of simple rate of return and annualised adjusted rate of return has led to the conclusion that investors obtained positive return from more percentage of par IPOs than premium IPOs and further issues of share capital not only on first trading day but also at all points of time covered by the study. Primary market investors obtained positive return in different slabs from 88%, 82%, 75%, 55%, 28% and 22% par IPOs, 78%, 56%, 45%, 36%, 26% and 20% Premium IPOs and 55%, 40%, 45%, 37%, 16% and 13% further issues of share capital on first trading day, after a period of 3 months, 6 months, 1 year, 2 years and 3 years from first trading day respectively. This finding gains more weight when we compare the loss suffered by the investors from different types of equity issues at different points of time. More specifically, the original allottees suffered loss between -1 to -100% from 12%, 18%, 25%, 45%, 72%, and 80% par IPOs, 22%, 44%, 55%, 64%, 74%, and 80% premium IPOs and 45%, 60%, 55%, 63%, 84% and 87% further issues of share capital at same points of time. Contrary to this, OFS issues performed better than other types of equity issues after a period of 2 and 3 years from first trading day. On the basis of these
results, it may be concluded that investment in new issues proved more beneficial to those investors who sold out their allotted shares in the short-run period and the investors who kept their allotment for a long period of 2 to 3 years suffered heavy losses as majority of the issues were traded at the market prices which were far below the issue prices. The study finds that market punished every type of equity issue in the long-run.

27. This study covered a large number of issues floated during the initial years of capital market reforms when issuer companies got freedom to price their public issues. As a result of change in market scenario, a bull run prevailed in both primary and secondary markets which coupled with investors’ optimism helped the companies to mobilise resources on the basis of rosy projections in the offer documents and by excessively overpricing the public issues. On listing of shares, majority of the issues performed well but as promoters started disposing off their excess stock of shares, the market prices fell down sharply and original allottees got trapped into the game of promoters. In this way medium to long term investors suffered heavy losses at the time of their exit from the market. However, the problem of negative return cannot be totally attributed to overpricing of issues as the return in secondary market depends on numerous other factors more recently the factor of FIIs flow of funds into the capital markets of India and developments in other markets of world have contributed a lot to the present state of Indian capital markets.

28. The coefficient of variation of the rate of return measured at six points of time covered by the study revealed that the par IPO of HDFC Bank, premium IPO of GRML Capital Markets Ltd, further issue of share capital of SBI Bank and OFS issues of Marico Industries Ltd and Maruti Udyog Ltd provided most stable rate of return to the investors during the period under study.

29. Issue size-wise analysis of different types of equity issues based on average return revealed that medium sized par IPOs between Rs. 25 crore to Rs. 49 crore, large sized premium IPOs between Rs. 500 crore to Rs. 999 crore and largest sized further issues of share capital of Rs. 1000 crore and above provided maximum return to the investors during the period under study. In case of OFS type of issues, large sized issues between Rs. 500 crore to Rs. 999 crore performed better than the issues of other sizes covered by the study.
30. Comparative analysis of different types of equity issues based on the age of the issuer companies have shown that in case of par IPOs, premium IPOs, further issues of share capital and OFS type of issues, the best performance was provided by the issues brought by companies between the age of 6 to 10 years, above the age of 50 years, between the age of 36 to 40 years and 21 to 25 years respectively. In case of further issues of share capital, worst performance was provided by the issues floated by younger companies between the age of 1 to 5 years. From these results, the study finds that older companies’ issues performed better than younger companies’ issues.

31. The industry-wise performance of equity issues revealed that from among basic and conventional industries, the issues of power and telecommunication industry provided highest average return of 114.38% and issues of engineering and capital goods industry provided negative return of 14.90% to the investors during the period under study. Even the issues of steel and textile industry could not provide a very high return to the investors during the period under study. Among the issues of banking and finance and investment industries, the issues of banking industry provided better return. From among the issues of new generation industries, the issues of IT industry performed better than the issues of couriers, travel, airlines, hotels and tourism industries. Further, the issues of agro based industry provided reasonably good return to the investors during the period under study.

32. Merchant bankers-wise performance of equity issues revealed that the best performance on the basis of average return was provided by the issues managed jointly by the financial institutions and/or public sector banks where positive return to the investors was provided by 65% issues and negative return by 35% issues. Though, the services of non-bank private sector merchant bankers were availed by maximum 26% issuer companies covered by the study but the issues handled by them failed to perform better than the issues handled by other group of merchant bankers on the basis of first trading return as well as average return.

33. The results of the Linear Multiple Regression Analysis carried to find out the impact of offer document selected disclosures on first trading day return as well as average return, have led to the conclusion that the disclosures taken in
the regression model failed to establish their statistically significant impact on both First Trading Day Return (FTDR) and average return obtained by the investors during the period under study. Though the coefficient of determination \( R^2 \) explained about 97 percent variation in FTDR of par IPOs due to disclosures under study but individual impact of the disclosure of total assets, net worth, EPS, BV, average dividend paid, age of the issuer, promoters’ stake in post issue capital and issue size is positive but statistically non-significant. Likewise, the \( R^2 \) in case of further issues of share capital indicated about 32 percent variation in average return as a result of disclosures and this association has been found significant at 5 percent level but the regression coefficient of only promoters’ stake in post issue capital has been found significant at 5 percent level. The regression coefficient of average dividend paid in case of par IPOs has also been found highly significant in explaining average return obtained by the investors during the period under study. Except this, no other disclosure regressed in the model could explain the return obtained by investors during the period under study.

34. The issue size-wise impact of disclosures measured by Linear Multiple Regression Analysis revealed that the disclosure of net worth proved its largest impact on first trading day return in case of equity issues between the size of Rs. 10 to Rs. 24 crore as the regression coefficient of average net worth is not only positive but significant at 1 percent level. The \( R^2 \) in this case explained about 13.1% variation in FTDR and which has been found significant at 5 percent level. The regression coefficient of average turnover has been found statistically significant in explaining the average return obtained by the investors from the equity issues between the size of Rs. 10 crore to Rs. 24 crore. Besides this, the coefficient of net worth is positive and significant at 1 percent level in case of equity issues between the size of Rs. 25 to Rs. 49 crore. All other regression coefficients failed to prove their influence on FTDR as well as average return obtained by the investors from equity issues of different sizes.

35. The industry-wise impact of disclosures on FTDR investigated through Linear Multiple Regression Analysis found the regression coefficient of average net worth and issue size significant in explaining FTDR in case of equity issues of
IT industry. Likewise, the regression coefficients of average BV in case of issues of chemical good industry, of average net worth and EPS in case of issues of pharmaceutical industry and of average BV, promoters’ stake in post-issue capital and issue size in case of issues of engineering and capital goods industry established statistically significant impact on average return obtained by the investors from the issues of these industries during the period under study. Besides this, the coefficient of average EPS has been found highly significant in explaining average return from the issues of banking industry.

The $R^2$ in case of equity issues of banking and mining, mineral and metal industries indicated large proportion of change in average return due to disclosures covered by the study. Except this, no other disclosure could establish its statistically significant impact on equity issues return of different industries.

36. It has been found from the regression analysis that the coefficient of determination ($R^2$) in case of issues handled by FIs with private sector banks/non-bank private sector merchant bankers explained about 75 percent variation in average return due to disclosures under study which indicates that the disclosures taken in the regression model established significant impact on average return obtained by the investors during the period under study. The regression coefficients of average total assets, average NAV and average dividend paid have been found positive and significant at 5 percent level implying thereby that the disclosure of total assets, net asset value and percentage of dividend paid by the companies in their offer documents have positively affected the average return obtained by the investors. Barring this, no other disclosure could establish its impact on equity issues return obtained by the investors from the issues handled by other groups of merchant bankers during the period under study.

37. The results of Simple Linear Regression Analysis carried to find out the dependence of equity issues average return on market return have led to the conclusion that the market return explained a large proportion of change in equity issues average return at some points of time covered by the study.

38. When a comparison is made between the results of Linear Multiple Regression Analysis with the results of Simple Linear Regression Analysis, we arrive at
the conclusion that the offer document disclosure taken in the regression model failed to influence the equity issues return (both first trading day return as well as average return) obtained by the investors in most of the cases but the regression coefficient of market return has been found statistically significant in explaining the variation in equity issues return obtained by the investors at some points of time covered by the study. The study finds that the equity issues return in India is not dependent on offer document disclosures, rather influenced by market return to some extent and hence, largely affected by numerous other factors not covered by the study.

39. The study reveals that a large 51% companies covered by the study mobilised funds from the market without evolving any mechanism to redress the grievances of their inverters. It is revealed that only 37% issuers mobilised resources after establishing investors’ grievances cell at the company level along with agreement with the Issue Registrar to handle investors’ grievances for six months to one year period.

40. There are sufficient provisions in Companies Act, 1956 and SEBI Act 1992 to take legal action against the defaulting and vanishing companies but it has been noticed that the investors’ culprits were not brought to books in time. The huge time gap between the scam dates and dates on which legal action was initiated against the scamsters and fly-by-night operators, compel us to conclude that the law enforcement is very poor in India. The law enforcing agencies failed to discharge their duties which resulted into undue delay in taking action against the dubious promoters. Besides this, the network created by the scamsters by establishing their links with the officials of regulatory bodies, banks, depositaries participants and even Government put a question mark on their independent working and has proved a major hindrance in the increase of investors population.

41. Though, the ‘Investor Assistance and Education’ office of SEBI, ‘Department of Investors Services’ of BSE and ‘Investor Service Cell’ of NSE has helped the investors in resolving their grievances with the issuer companies and market intermediaries, but the mind-blowing number of investors’ grievances reaching the offices of these agencies on regular basis speak themselves about the wounds given to the investors by non-caring managements/promoters.
9.7 SUGGESTIONS

On the basis of the findings of the present study, following suggestions are made for the healthy growth of primary capital market of India with the main thrust on protection of the interest of the investors in the market:

1. The SEBI needs to take some measures to ensure the active participation of retail individual investors in price discovery through book building process as presently the big investors like FIIs, FIs, banks and mutual funds (QIBs category of investors) have more say in price discovery process because a large proportion of the issue is reserved for them. Retail individual investors have no other option but to apply for and accept the shares at a price discovered through the active involvement of big investors. The active participation of retail individual investors can be ensured by enhancing their allocation quota of 25%/ 30% to at least 40%. Furthermore, SEBI’s guidelines on margin money make step-motherly treatment with retail investors as they are supposed to pay 100% of money payable on application/bid as margin money where as the investors of QIBs category need to pay minimum 10% of money payable on application. With this huge difference, big investors can influence the price discovery process. This is unfair with retail investors. Something needs to be done to bring parity among different types of investors/bidders.

2. The issuer company and book runner lead manager can also help the retail individual investors by issuing shares to them at a price which is at least 5% to 10% less than book building discovered price. This concession is necessary to nullify the effect of additional benefit enjoyed by the big investors in the Indian context.

3. New companies should not be allowed to tap the capital market unless their promoters do something concrete on ground and show their firm commitment to the project for which they propose to collect funds from the market. No objection certificate obtained from Pollution Control Board, Water and Electricity sanction obtained from concerned authorities, land purchased, plant and machinery order placed and means of project finance fully tied-up,
should be made necessary conditions for bringing public issue for the new companies.

4. If the Government and the regulatory bodies sincerely want to protect the interest of the investors then the companies convicted by duly constituted committees for committing irregularities of serious nature, loan defaulter companies and the companies which failed to redress the grievances of their investors within a timeframe should be banned to tap the market for mobilisation of resources. Merely disclosing these unfavourable points under risk factors will not serve the purpose. BSE should also come down heavily and promptly on the companies which fail to comply with the listing requirements. Undue delay in taking action against the culprit companies has shaken the confidence of the investors in India. In order to protect the interest of the investors, the law enforcing agencies should be given free hands.

5. There is a need to make project appraisal route as mandatory requirement for floating a public issue in the market. At present, project appraisal route is optional for the issuer companies which require 15% participation of the FIs/scheduled commercial banks in the total issue of which at least 10% comes from the appraiser/s. Mandatory requirement of project appraisal with existing limit of participation can solve the problem of tracking the end use of issue proceeds to a great extent because appraising institutions with their money at stake will certainly monitor the use of issue proceeds for the objects stated in the offer document.

6. The liability of promoters should be made unlimited and for this purpose necessary provisions should be incorporated in Companies Act, 1956. If this change is made, no promoter will dream of diverting the issue proceeds for his personal gains.

7. There is an urgent need to tighten the grip over the issue managers. The whole exercise of funds raising is completed under their guidance. They issue due diligence certificate certifying the compliance to DIP guidelines of SEBI. If they are found guilty, they should not be let out after a warning or nominal fine. Instead they should be penalised considering stringent measures such as cancellation of their registration.
8. There is a scope for improvement in the disclosure made under the heading ‘Basis for the Issue Price’ in case of book building issues. Presently the issuer companies are showing dots (●) at many places in their red-herring prospectuses like dot at issue size, post-issue NAV and minimum return required on expanded net worth. It is being stated that these values will be known only on finalisation of issue price after the completion of book building process. Even majority of the issuer companies are skipping to disclose their means of finance taking the same excuse. In our views, issuer companies should disclose the figures of issue size, post-issue NAV, minimum return required on expanded net worth and means of finance by finding out estimated resources that can be mobilised on the basis of cap of the band or floor price or even on average figure of cap of price band and floor price. It will serve better purpose and will give a rough idea to the investors about these financials of the issuer company.

9. From the disclosure practice being followed by issuer companies, it has been noticed that the banking companies are not disclosing their requirement of funds in their offer documents and instead are stating that the issue proceeds after meeting issue expenses will be used for regular business operations. This is incomplete disclosure which is unjustified. When these banks sanction loans, they take auditor certified reports regarding funds requirement from their clients. How can they approach the investors without disclosing their own requirement of funds? SEBI should also take serious note of this practice and should make it mandatory for the banks to clearly show their requirement of funds in the offer documents.

10. Disclosure of debt to equity ratio and capacity utilisation percentage should be made mandatory disclosure of offer document. It will help the investors to understand in a better way the risk involved in the issue and the efficiency with which existing assets have been used by the issuer company.

11. When some irregularity or capital market scam surfaces, it has been noticed that the capital market regulatory bodies start blaming each other. This situation arises when there is lack of clarity in the functioning of these bodies. An integrated approach with compete co-ordination between SEBI, DCA, RBI and Stock Exchanges is necessary to take prompt action against the
scamsters and fly-by-night operators. There is an urgent need to form a co-
ordination committee on permanent basis in which the representatives of
SEBI, MCA, RBI, Stock Exchanges and Depositories should be included.
This will certainly help in taking immediate action against the guilty in order
to safeguard the interest of investors in the market.

12. Grievance Redressal System needs to be made speedier. SEBI should not
merely act as a middleman to deliver the complaints of investors to different
companies. Further, the requirement of disclosure of the figures of unresolved
investors’ complaints in the risk factors will not solve the problem. SEBI’s
active involvement is must. The companies which fail to resolve the
grievances of the investors within a time frame should not be allowed to tap
the market for mobilisation of resources or they should be given a time to
resolve the grievances and should be allowed to go ahead with the public
issue only after redressal of pending grievances.

13. Majority of the grievances relate to small investors because either they are not
fully aware about the capital market or they come to know about the crisis
when everything has happened. There is an urgent need to take the
representative of small investors in board of directors of the company who
can look after the matters concerning small investors. He can be taken on the
recommendation of Investors’ Associations registered with SEBI.

14. Investors’ Protection Funds set up by MCA and Stock Exchanges should also
be used to pay compensation to the investors. Presently, the fund created by
MCA is used only for awareness programs/workshops and fund created by
Stock Exchanges is used for making payment due to the default of the
members of the exchanges up to a specified amount. There is a need to
broaden the coverage of the fund.

15. Negative return due to overpricing of issues and volatility of the capital market
compel us to think on exploring the possibility of introducing the concept of
insurance in public issues of equity shares in India. If crop insurance is
possible where expected yield is dependent on unpredictable climatic
conditions, why the contract of indemnity cannot be made with the insurance
companies for one year from the date of listing of shares. For this, the issuer
companies from issue proceeds, issue managers from their fee and the investors from their pockets should contribute towards the premium payable to the insurance companies. The liability of insurance company will arise only if market price falls below the issue price within one year from the date of listing. The problem of negative return can also be solved by making compulsory buyback of shares by the issuer company when it fails to sustain their issue price on Stock Exchange after listing of shares.

16. Last but not the least; investors’ education is the need of the hour. They should be well aware of all the positive and negative features of the investment in the securities market. They should not sit blindly after investing their hard earned money in the new issues of the companies. They should closely watch and understand the movements of the market and should study the possible reasons responsible for the movement/volatility of the market. Though, SEBI, MCA and Stock Exchanges have conducted nationwide seminars/workshops and distributed educative material relating to capital market operations and intermediaries, yet lot more is required to be done for the small as well as rural investors.

At the end, it may be said that the problem of fair issue price, offer document disclosures and integration of equity issues return with the performance parameters of the issuer companies can be solved to a great extent if above mentioned suggestions are given practical shape by the capital market regulatory bodies. When investors’ interests are adequately protected by sufficient safeguards and they are given their due place and respect by the issuer companies, it will boost the confidence of investors which is a pre-requisite for the growth of the market on regular basis.

9.8 LIMITATIONS OF THE STUDY

Like any other research project, the present study also has certain limitations as stated below:

1. The present study is based on secondary data which is assumed to be accurate and reliable. However, due to different accounting practices of the issuer companies, there may be certain discrepancies.

2. This study is limited to public issues of equity shares only. Public issues of preference shares (convertible as well as non-convertible) and debentures
(fully convertible, partly convertible and non-convertible) have not been covered by the study.

3 All the figures have been taken at current prices. The impact of inflation has not been taken care of.

4 The study covers a period of 12 years and the findings are based on a sample of 322 public equity issues. The results obtained may not represent all the aspects of primary capital market of India.

5 The average rate of return, used in the study, is based on total return obtained by investors at six points of time of which first trading day return and return after 3 and 6 months are on unannualised basis whereas return after 1 year, 2 years and 3 years are on per annum basis.

9.9 AREA FOR FURTHER RESEARCH

Following are some promising areas of further research in the field of primary capital market.

1. The findings of this study are based on a sample of 322 public equity issues of the size of Rs. 10 crore and more floated during a period of 12 years from 1992-93 to 2003-04. The entire aspect of determinants of rate of return of public equity issues needs to be further examined by increasing the sample size and period of study. In addition, the impact of Foreign Institutional Investors’ (FIIs) participation in public issues on equity issues return should be investigated as it has not been covered by the present study.

2. Studies can be conducted to evaluate the performance of euro issues and to compare the same with the performance of issues floated in Indian capital market.